

## The Negotiable Instruments Act, 1881

### Learning Objectives

In this Chapter, the students will understand the

- ◆ Meanings of various negotiable instruments and their differences
- ◆ Negotiation and assignability of instruments
- ◆ Presentment and dishonour of instruments

### 2.1 Introduction

The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce making provision of giving sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, the trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry on with it the bulk of the currency in force. The source of Indian law relating to such instruments is admittedly the English Common Law. The main objective of the Act is to legalise the system by which instruments contemplated by it could pass from hand to hand by negotiation like any other goods.

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It deals with Promissory Notes, Bills of Exchange and Cheques. These are the three most common types of negotiable instruments. The Act applies to the whole of India and to all persons resident in India, whether foreigners or Indians. The provisions of this Act are also applicable to Hundis, unless there is a local usage to the contrary. Other native instruments like Treasury Bills, Bearer debentures etc. are also considered as negotiable instruments either by mercantile custom or under other enactments.

### 2.2 Meaning of Negotiable Instruments

It is an instrument which is transferable (by customs of trade) by delivery, like cash, and is also capable of being sued upon by the person holding it for the time being. The property in such an instrument passes to a *bona fide* transferee for value.

Section 13 of the Negotiable Instruments Act, 1881 does not define a “negotiable instrument”

although it mentions only three kinds of negotiable instruments namely, bills, notes and cheques. But it does not necessarily follow that there can be no other negotiable instruments than those enumerated in the Act. Section 17 of the Transfer of Property Act, 1882 speaks of “instruments which are for the time being, by law of custom, negotiable”, implying thereby that the Courts in India may follow the practice of the English Courts in extending the character of Negotiable Instruments Act. Thus in India, Government promissory notes, Shah Jog Hundis, delivery orders and railway receipts for goods have been held to be negotiable by usage or custom of trade.

### 2.3 Characteristics of Negotiable Instruments

- (i) **Written instrument with signature:** A negotiable instrument is a written document and is considered as complete and effective only when it is duly signed.
- (ii) **Negotiable Instrument made or drawn for consideration:** It is presumed by law that every negotiable instrument is made or drawn for a consideration. Consequently, there is no necessity to state such a position. But it is not an irrebuttable presumption. It must be rebutted by proof that the instrument had been obtained from its lawful owner by means of fraud, undue influence or for an unlawful consideration. The onus of proof is on the person who challenges the existence of consideration (i.e., the defendant). If the defendant is able to make out a good case by proving the want of consideration then the responsibility to prove that there was consideration would shift on to the plaintiff.
- (iii) **Transfer/negotiation by endorsement/ delivery:** A negotiable instrument can be transferred from one person to another by endorsement and delivery if it is an instrument payable to order, and by mere delivery, if it is a bearer instrument.
- (iv) **Bonafide and valuable consideration entitles good title to transferee:** The transferee, who takes the instrument bona fide and for valuable consideration, obtains a good title despite any defects in the title of the transferor. To this extent, it constitutes an exception to the general rule that no one can give a better title than he himself has.

#### Key Points

- ◆ A negotiable instrument is a written and signed document entitling a person to a sum of money specified in it and which is transferable from one person to another person either by mere delivery or by endorsement and delivery.
- ◆ The property in N.I passes to the bonafide transferee for value notwithstanding any defect in the title of the person delivering him.

### 2.4 Definitions

- (a) **Promissory Note:** According to section 4 of the Act, A promissory note is an instrument (not being a bank note or a currency-note) in writing containing an unconditional undertaking,

signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.

For *Example*: “A” signs instrument in the following term:-

(1): “I promise to pay “B” or order ₹ 500”,

Parties to this promissory note are: (i) “A”, the maker, who promises to pay, and (ii) “B”, the Payee, to whom a promise to pay is made by the maker,

(2): “I acknowledge myself to be indebted to “B” in ₹1,000, to be paid on demand, for the value received.”

(3): “I promise to pay “B” ₹ 500 seven days after my marriage with “C” – is not a promissory note.

(4): “I promise to pay “B” ₹ 500 and to deliver him my black horse on 1<sup>st</sup> January next - is not a promissory note.

The requirements of a promissory note are:

(i) *It must be in writing*: This means that the engagement cannot be oral. There is no prescribed form or language for this; even the word ‘promise’ need not be used. What is necessary is that whatever language is used, it must clearly show that the maker is unconditionally bound to pay the sum.

(ii) *The promise to pay must be unconditional*: If a condition is attached to the ‘promise to pay’ then the instrument will not be construed as a promissory note. Suppose, A signs an instrument made out as follows, “I promise to pay B ₹ 500 on D’s death, provided D leaves me enough to pay that sum”. The instrument will not be a promissory note. But if an instrument runs as: “I acknowledge myself to be indebted to B of ₹ 500 to be paid on demand, for value received”. This instrument would be a promissory note.

It may be noted that a promise to pay will not be conditional under Section 4, where it depends upon an event which is certain to happen but the time of its occurrence may be uncertain. For *example*, where a promissory note is in this form: “I promise to pay B ₹ 2,000, 15 days after the death of C”, it is not conditional as it is certain that C will die though the exact time of his death is uncertain.

(iii) *The amount promised must be certain and a definite sum of money*: Certainty is one of the essential characteristics of a promissory note. Certainty must be as to the amount and also as to the person by whose order and to whom payment is to be made. For *example*, where an instrument contains: “I promise to pay B ₹ 350 and all other sums which shall be due to him”, it is not a valid promissory note as the sum is not certain within the meaning of Section 4.

(iv) *The instrument must be signed by the maker*: It is incomplete till it is so signed. Since the signature is intended to authenticate the instrument it can be on any part of the instrument.

(v) *The person to whom the promise is made must be a definite person*: The payee must be

a certain person. Where the name of the payee is not mentioned as a party, the instrument becomes invalid. Remember that a promissory note cannot be made payable to the maker himself. Thus, a note which runs "I promise to pay myself" is not a promissory note and hence invalid. However, it would become valid when it is endorsed by the maker. This is because it then becomes payable to bearer, if endorsed in blank, or it becomes payable to the endorsee or his order, if endorsed specially.

In connection with the promissory note, you should also remember that: (a) no particular form of words is necessary to constitute a promissory note. (b) not necessary to insert in pro-note a statement of consideration that it is "for value received" because law itself presumes that every negotiable instrument is made for consideration ; (c) place of payment and date of making it, need not be stated in the note; (d) an undated instrument is valid and it will be treated as having been made on the date of its delivery; and (e) an ante-dated or post dated instrument is not invalid. (f) not necessary that the words 'or order' must be written after the name of the payee. (g) no attestation is needed in a pro-note though attestation of a pro-note is neither required nor prohibited by law .

*N.B. The words "or to the bearer of the instrument" still appear in Section 4 to the Act, since these have not yet been deleted therefrom by the Parliament : Nevertheless, in view of the provision contained in Sub-section (2) of Section 31 of the Reserve Bank of India Act, the aforesaid words have become inoperative or ineffective. Therefore, the present position is that no person in India other than the Reserve Bank of India or the Central Government can make or issue a promissory note payable to the bearer of the instrument.*

**(b) Bill of Exchange:** Before going into the definition, you must know how a bill of exchange ordinarily comes into existence. It comes into being, when a trader decides to sell goods on credit. Suppose, A sells goods worth ₹ 800 to B, and allows him three months' time to pay the price. A will then draw a bill on B in the following terms "Three months after date pay to my order the sum of ₹ 800 for value received". After signing the bill, A will present it to B for acceptance. If B writes across the bill 'accepted', it will indicate that B undertakes the liability to pay a sum of ₹ 800 within the time stipulated therein. Here A is the drawer, B is the drawee and after acceptance B will be the acceptor. A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument (Section 5).

Thus, from above we can draw an inference that bill is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.

#### Requirements of Bill of Exchange:

- (i) The bill of exchange must be in *writing* and be drawn in any form complying with the requirements of section 5.
- (ii) There must be an *order to pay*. It is the essence of the bill that its drawer orders the drawee to pay money to the payee. Order in this section does not mean a command, but

a direction for payment.

- (iii) This order must be *unconditional*, as the bill is payable at all events. Thus, it is absolutely necessary for the drawer's order to the drawee to be *unconditional*. The order must not make the payment of the bill *dependent on a contingent* event. A conditional bill of exchange is invalid.

Bill should not be made payable out of a particular fund, as thereby the payment is made dependent upon the existence or sufficiency of such fund. Where a bill contains an order to pay the amount specified therein out of a particular fund it will be conditional and therefore invalid.

- (iv) The *drawer must sign* the instrument. The instrument without the proper signature will be inchoate and hence ineffective. It is permissible to add the signature at any time after the issue of the bill. But if it is not so added, the instrument remains *ineffectual*.
- (v) The drawer, the drawee (acceptor) and the payee are the *necessary parties to a bill* and are to be specified in the instrument with reasonable certainty. You should remember that all these three parties may not necessarily be three different persons. One can play the role of two. But there must be two distinct persons in any case.
- (vi) The *sum must be certain* [what we have discussed on this point in relation to promissory note vide requirement (iii) on page 3 will equally hold good here].
- (vii) The *medium of payment must be money* and money only. The distinctive order to pay anything in kind will vitiate the bill.

*Thus, a bill must contain an order to pay in terms of money only and should be definite amount of money.*

- (viii) *The bill must be delivered to the payee, otherwise the bill be inchoate and hence ineffective.*

(c) Distinction between a Promissory Note and a Bill of Exchange: The distinctive features of these two types of negotiable instruments are tabulated below:

Promissory Note	Bill of Exchange
1. It contains a <i>promise</i> to pay	It contains an <i>order</i> to pay.
2. The liability of the maker of a note is <i>primary and absolute</i> (Section 32).	The liability of the drawer of a bill is <i>secondary and conditional</i> . He would be liable if the drawee, after accepting the bill fails to pay the money due upon it provided notice of dishonour is given to the drawer within the prescribed time (Section 30)
3. It is presented for payment without any previous <i>acceptance</i> by maker.	If a bill is payable some time after sight, it is the <i>required to be accepted</i> either by the drawee himself or by someone else on his behalf, before it can be presented for payment.

## 2.6 Business Laws, Ethics and Communication

4. The <i>maker</i> of a promissory note stands in <i>immediate relationship</i> with the the <i>payee</i> (Explanation to Section 44) and is primarily liable to the payee or the holder.	The <i>maker or drawer</i> of an accepted bill stands in <i>immediate relationship</i> with the <i>acceptor</i> and the <i>payee</i> (Explanation to Section 44).
5. It cannot be made payable to the maker himself, that is the <i>maker and the payee cannot be the same person</i> .	In the case of bill, the drawer may order the payment to be made to himself also. Thus, <i>the drawer and payee or the drawer and the drawee may be the same person</i> .
6. In the case of a promissory note there are only <i>two parties</i> , viz., the maker (debtor) and the payee (creditor).	In the case of a bill of exchange there are <i>three parties</i> , viz., drawer, drawee and payee, and any two of these three capacities can be filled by one and the same person.
7. A promissory note <i>cannot be drawn in sets</i> .	The bills can be <i>drawn in sets</i> .
8. A promissory note can <i>never be conditional</i> .	A bill of exchange too cannot be drawn conditionally, but it <i>can be accepted conditionally with the consent of the holder</i> . It should be noted that neither a promissory note nor a bill of exchange can be made payable to bearer on demand.
9. In case of <i>dishonour</i> of note, <i>notice is not required</i> to be given to its maker	<i>Notice of dishonour</i> of a bill is <i>required</i> to be given to all the parties.

(d) **Definition of Cheque:** A “cheque” is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

*Explanation I:* For the purposes of this section, the expressions-

- (a) “a cheque in the electronic form” means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;
- (b) “a truncated cheque” means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

*Explanation II:* For the purposes of this section, the expression “clearing house” means the clearing house managed by the Reserve Bank of India or a clearing house recognized as such by the Reserve Bank of India.’ (Section 6, Negotiable Instruments Act, 1881). That is to say, it is a bill drawn on a banker, which is payable on demand.

The Reserve Bank of India vide *Notification No. RBI/2011-12/251 DBOD.AML BC.No.47/14.01.001/2011-12, dated 4<sup>th</sup> November,2011* directed that the validity of Cheques/Pay Orders/Banker's Cheques will be reduced from the period of six months to three months from the date of such instruments with effect from 1<sup>st</sup> April,2012.

A cheque being a species of bill of exchange, it must, under Section 5, be signed by the drawer and must contain an unconditional order on a specified banker to pay a certain sum of money to or the order of the specified person or to the bearer of the instrument. A cheque, however, is a peculiar type of negotiable instrument in the sense that it does not require acceptance; also it is not meant to be payable to bearer on demand. A cheque may be drawn up in three forms, viz., (i) bearer cheque (*i.e.*, one which is either expressed to be so payable or on which the last or only endorsement is an endorsement in blank); (ii) order cheque *i.e.*, one which is expressed to be so payable or which is expressed to be payable to a particular person without containing any prohibitory words against its transfer or indicating an intention that it shall not be transferable (Section 18); and (iii) crossed cheque is a cheque which can be only collected through a banker.

On account of the similarities and the difference between the cheque and bill of exchange it can be said that "All cheques are bills of exchanges but all bills of exchanges are not cheques"

It has following similarities:

Both are the bills of exchange.

Both have three parties, the drawer, drawee and the payee.

The drawer and the payee may be one and the same person in both the instruments.

Both must written and signed

Both must contain an unconditional order to pay a certain sum of money.

Both may be endorsed.

(e) Difference between Cheque and Bill of Exchange:

- (1) In the case of a cheque the drawee- *i.e.*, the person on whom the bill is drawn-must always be banker whereas in the case of a bill of exchange the drawee may be any person.
- (2) No days of grace are allowed in the case of a cheque, and a cheque is as a rule, payable immediately on demand, whereas three days' grace is allowed in the case of a bill which is not payable on demand.
- (3) In the case of dishonour of a cheque, bank only gives the reason in writing but there is no system of Noting or Protest, whereas in the case of a bill, there can be Noting and Protest to prove that the bill has been dishonoured.
- (4) A cheque is always payable on demand, whereas a bill which is other than a cheque may be either a time bill or it may be payable on demand.

- (5) Cheques do not require to be stamped in India, whereas bills must be stamped according to the law. In England and several other countries, cheques also are required to be stamped.
- (6) A cheque may be crossed, whereas a bill cannot be crossed.

**Key points:**

- ◆ A promissory note is an unconditional undertaking, written and signed by the maker to pay a certain sum of money only to or to the order of a certain person. It does not include a bank note or currency note.
- ◆ A bill of exchange is an unconditional written order signed by the drawer, directing a certain person to pay a certain sum of money to the specified person or to his order or to the bearer of the bill.
- ◆ A cheque is a bill of exchange drawn on a specified banker and payable only on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

(f) **Bank Draft:** *A bank draft is a bill of exchange drawn by one bank upon itself or another bank for a sum of money payable to order on demand.*

Where one branch of a bank validly debits the account of its customer and transfers the money to another branch or head office, the transaction is not one merely of a transfer of the banks' own money from one branch to another or one bank to another but involves the receipt of the money by the transferee bank and hence it becomes a collecting bank.

Section 85A is added to protect the bankers against forged or unauthorized endorsements on demand drafts, drawn by one branch of a bank upon another branch of the same bank.

According to section 131A of the Act, the provisions as given from section 123 to 131 shall be applicable to any draft, as defined in section 85A, as if the draft were a cheque. Thus a banker collecting the crossed bank draft is entitled to the same protection under Section 131A as available under Section 131 to a bank collecting a crossed cheque.

A draft is drawn either against cash deposited at the time of its purchase or against debit to the buyer's operational bank account with the banker. The buyer of the draft generally furnishes particulars of the person to whom the amount thereof should be paid. The banker charges for his services a small commission. The draft like a cheque, can be made payable to drawer on demand without any legal objection thereto, since the Reserve Bank of India Act, under Section 31, specially allows such a draft be issued.

Moreover, where a draft purports to have been endorsed by or on behalf of the payee the paying bank is discharged from liability by its payment in due course even though the endorsement of the payee has been forged. This affords great protection to the paying banker in so far as it is always possible for the paying banker to identify the signature of the payee.

(g) **Marked cheques:** A cheque need not be presented for acceptance. Therefore the



drawee of the cheque *i.e.*, the banker, is under liability to pay, to the person in whose favour the cheque is drawn. The banker, however, will be liable to his customer (drawer), if he wrongly refuses to honour the cheque. In such a case, action can be taken by the customer against the banker for the loss of his reputation. In certain cases, however, a cheque is marked or certified by the banker on whom it is drawn as "good for payment". Such a certification or marking is strictly not equivalent to an acceptance *and the Bank so marking the cheque cannot be made liable as an acceptor. If a post dated cheque is marked good for payment, that means that on the day of marking there are sufficient funds to meet the cheque. That does not guarantee that sufficient funds would be available on the day of payment of such post dated cheque. In [Bank of Baroda vs. Punjab National Bank Ltd.(1944)AC 176] it was held that such certification was not an acceptance within the meaning of section 7 of the Negotiable Instruments Act and ,therefore the bank was not liable as an acceptor..*

(h) **Crossed cheque:** (i) *The usage of crossing cheques:* Cheques are usually crossed as a measure of safety. According to section 123, crossing is made by drawing two parallel transverse lines across the face of the cheque with or without the addition of certain words. This is known as general crossing. The usage of crossing distinguishes cheques from other bills of exchange. The object of general crossing is to direct the drawee banker to pay the amount of the cheque only to a banker, to prevent the payment of the cheque being made to wrong person.

(ii) *Special crossing:* According to section 124, where a cheque bears across its face an entry of the name of a banker either with or without the words "not negotiable", the cheque is considered to have been crossed specially to that banker. In the case of special crossing the addition of two parallel transverse lines is not essential though generally the name of the bank to which the cheque is crossed specially is written between two parallel transverse lines.

(iii) *Crossing after issue:* As per section 125 of the Act, (i) If cheque has not been crossed, the holder thereof may cross it either generally, or specially. (ii) If it is crossed generally, the holder may cross it, specially. (iii) If it is crossed, either generally or specially the holder may add the words "not negotiable". (iv) If a cheque is crossed specially, the banker to whom it is crossed, may again cross it specially to another banker, his agent, for collection. This is the only case where the Act allows a second special crossing by a banker and for the purpose of collection [Akrokerri(Atlantic) Mines Ltd vs. Economic Bank (1904) 2 K.B. 465 ]. It may be noted that the crossing of a cheque is an instance of an alteration which is authorised by the Act.

(iv) *Payment of cheque, crossed generally or specially (Sections 126 & 127):* If a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker. Again, where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed or his agent for collection.

According to section 127, where a cheque is crossed specially to more than one banker except when it is crossed to an agent for the purpose of collection, the banker on whom it is

drawn shall refuse payment thereof. This is because, in such a case, the instruction by the drawer would not be clear.

***Note: It is necessary in all cases, to specify in the second special crossing, that the banker in whose favour it is made is an agent of the first banker for collection.***

(v) *Payment in due course of crossed cheque:* According to section 128, where the banker on whom a crossed cheque is drawn, pays it in due course, it is to be presumed that he has made payment to the true owner of cheque, though in fact, the amount of the cheque may not reach the true owner. In other words, banker making payment in due course is protected, whether the money is or is not, in fact, received by the true owner of the cheque.

(vi) *Payment out of due course :* According to section 129, any banker paying a crossed cheque otherwise than in accordance with the provisions of Section 126 shall be liable to the true owner of the cheque for any loss he may have sustained. Thus, ***if the bank pays a cheque out of due course, that is, in contravention of section 126, and the money does not reach the true owner, he can claim payment over again from the banker.***

(vii) *Cheque marked "not negotiable" :* According to section 130, a person taking a cheque crossed generally or specially bearing in either case the words 'not negotiable' shall not have or shall not be able to give a better title to the cheque than that title the person from whom he took had. In consequence if the title of the transferor is defective, the title of the transferee would be vitiated by the defect. But, in the case of a bill negotiated in the ordinary way, the title of the holder in due course would not be affected by the defect in the title of the transferor.

***Cheque crossed 'not negotiable' does not affect the transferability of the negotiable instrument in anyway. The cheque still continues to be transferable but only those rights are conveyed to the transferee which the transferor has.***

For example, X, by means of fraud, obtained from Y a cheque crossed 'not negotiable' and got it cashed at a bank other than the drawee bank. Y sued the bank for conversion. Is the bank liable for conversion? The effect of Section 130 of the Act, broadly, is that if the holder has a good title, he can still transfer it with a good title, but if the transferor has a defective title, the transferee is affected by such defects, and he cannot claim the right of a holder in due course by proving that he purchased the instrument in good faith and for value. As X in the case in question had obtained the cheque by fraud, he had no title to it and could not give to the bank any title to the cheque or the money, and the bank would be liable for the amount of the cheque for conversion. A similar decision was taken in *Great Western Railway Co. vs. London and Country Banking Co. (1901) A.C. 414* the facts whereof are exactly the same as the example cited above.

The addition of the words "not negotiable" in a crossed cheque has a special significance. The use of the words does not render the cheque non-negotiable but only affects one of the main features of negotiability. The general rule about the negotiability is that the holder in due course of a bill or promissory note or cheque takes the instrument free from any defect which might be existing in the title of the transferor. If the holder takes the instrument in good faith,

before maturity and for valuable consideration, his claim will not be defeated or affected by the defective title of the transferor. In case of any dispute, it is the transferor with the defective title who is liable. But the addition on the words "not negotiable" to the crossing of a cheque, makes the position different. When such a crossing is placed on a cheque, the holder in due course does not get any better title than what the transferor had. If the transferor had defective title, the title of the holder in due course also becomes defective. Therefore, he will have to refund the amount of the bill to the true owner. In other words, the principle of the '*nemo dat quod non habet*' - (that is, nobody can pass on a title better than what he himself has) will be applicable to a cheque with a "not negotiable" crossing.

Thus, cheques with "not negotiable" crossing are negotiable so long as their title is good. Once the title of the transferor or endorser become defective the title of the transferee is also affected by such defect and the transferee cannot claim the right of a holder in due course.

As per the instructions issued by the Reserve Bank of India (9-9-1992) it would be safer for the drawer to cross a cheque "not negotiable" with the words "account payee" added to it. The courts of law have held that "an account payee" crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt. The banker can disregard the direction only at his own risk and responsibility. In other words, an 'account payee' cheque can be collected only for the account of the payee named in the cheque and not for anyone else. A banker collecting an 'account payee' cheque for a person other than the payee named in the cheque may be held liable for conversion.

In other words, if the bank collects an account payee cheque for a person other than the payee it does so at its own risk. It is imperative on the part of collecting bank, therefore to take utmost care to enquire into the title of its customer and satisfy itself that there is no defect in the title of the customer presenting such cheque for collection.

(viii) *Cheque marked "Account Payee"*: It is a form of restrictive crossing, represented by the words "Account Payee" entered on the face of the cheque. Such a crossing acts as a warning to the collecting bankers that the proceeds are to be credited only to the account of the payee. If the collecting banker allows the proceeds of the cheque so crossed to be credited to pay any other account, he may be held guilty of a negligence in the event of an action for wrongful conversion of funds being brought against him. These words are not an addition to the crossing but are mere direction to the receiving or collecting bankers. These do not affect the paying banker who is under no duty to ascertain that the cheque in fact has been collected for the account of the person named as the payee.

In the case of a cheque bearing "Account Payee" crossing which is not specially crossed to another banker, the paying banker needs only to see that the cheque bears no other endorsement but that of the payee, and that it is otherwise in order. But where the cheque is also crossed specially, the paying banker must make payment only to the bank named in the crossing. It has been held that crossing cheque with the words "Account Payee" and mentioning a bank is not a restrictive endorsement so as to invalidate further negotiation of the cheque by the endorsee.

(ix) *Protection in respect of uncrossed cheque:* When a cheque payable to order purports to be endorsed by or on behalf of the payee and the banker on whom it is drawn pays the cheque in due course, he is authorised to debit the account of his customer with the amount so paid, even though the endorsement of the payee subsequently turns out to be a forgery, or though the endorsement may have been made by payee's agent without his authority. In other words, the banker is exonerated for the failure to direct either the genuineness of the validity of the endorsement on the cheque purporting to be that of the payee or his authorised agent.

For *example*, a cheque is drawn payable to B on order and it is stolen. Thereafter, the thief or someone else forges B's endorsement and presents the cheque to the bank for encashment. On paying the cheque, the banker would be able to debit the drawer's account with the amount of the cheque. Likewise, if the cheque, in the above case, was not stolen but instead presented for payment by B's agent on endorsing the same "Per pro" for B and the cheque is cashed, the banker could debit the account of the drawer. He would not be held guilty of the ground that he has cashed the cheque endorsed by the agent of B who has misappropriated the amount thereof.

*Example:* X drew a cheque payable to 'Y or on order'. Unfortunately it was lost and Y's endorsement was forged. Subsequently, the banker pays for the cheque. Is the banker discharged from liability? What will be the consequences if the drawer's signature were forged?

The paying banker is discharged from liability, despite the forged endorsement in favour of the payee, because of special protection granted by section 85(1) of the Negotiable Instruments Act, 1881.

In another instance, where the drawer's signature is forged, a banker remains liable to the drawer even by a payment in due course and cannot debit the drawer's account.

Such a protection is also available in respect of drafts drawn by one branch of a bank to another payable to order (Section 85A).

(x) *Protection in respect of crossed cheques:* When a banker pays a cheque (drawn by his customer), if crossed generally then to any banker, and if crossed specially then to banker, to whom it is crossed or his agent for collection (also being a banker), he can debit the drawer's account so paid, even though the amount of the cheque does not reach true owner.

The protection in either of the two cases aforementioned can be availed of, if the payment has been made in due course: *i.e.*, according to the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof in the circumstances which do not excite any suspicion that he is not entitled to receive payment of the cheque.

The condition of good faith and without negligence would be judged on the criteria as are applied for judging the conduct of a collecting banker. In brief, the payment should be made in ordinary course in circumstances in which a man of ordinary prudence would not suspect that the person claiming payment was not the true owner.

Even though the banker is protected for having made payment of the cheque to a wrong

person, the true owner of the cheque is entitled to recover the amount of the cheque from the person who had no title to the cheque.

(i) *Drawer, Drawee, Acceptor, Maker, Payee, etc.:*

- (i) The party who draws a bill of exchange or a cheque or any other instrument is called drawer.
- (ii) The party on whom such bill of exchange or cheque is drawn is called the drawee. In other words the person who is thereby directed to pay is called the drawee.
- (iii) The drawee of a bill of exchange who has signified his assent to the order of the drawer is called the acceptor. The acceptor becomes liable to the holder after he has signified his assent but not before.

Now a question would naturally arise as to who can be acceptors? Under Section 33 of the Act, no person except the drawee of a bill of exchange, or all or some of several drawees or a person named therein as drawee in case of need, can bind himself by an acceptance. Under Section 34, where there are several drawees of a bill of exchange who are not partners, each of them can accept it for himself; but none of them can accept it for another without his authority.

It follows from the aforesaid provisions that the following persons can be acceptors:

- (a) Drawee, *i.e.*, the person directed to pay.
  - (b) All or some of the several drawees when the bill is addressed to more drawees than one.
  - (c) A drawee in case of need.
  - (d) An acceptor for honour.
  - (e) Agent of any of the persons mentioned above.
  - (f) When no drawee has been named in a bill but a person accepts it, he may be stopped from denying his liability as an acceptor.
- (iv) Acceptance is ordinarily made by the drawee by signing of his name across the face of the bill and by delivery. Acceptance, therefore, means the signification of assent to the order of the drawer by delivery or notification thereof.

Under Section 26 and 27 of the Act, every person capable of legally entering into a contract, may make, draw, accept endorse, deliver and negotiate a promissory note, bill of exchange or cheque, himself or through a duly authorised agent. The agent may sign in two ways, viz., (a) he may sign the principal's name, for it is immaterial what hand actually signs the name of the principal, when in fact there exists an authority for the agent to put it there; (b) he may sign by procuration stating on the face of the instrument that he signs as agent. It is thus essential that the agent, while putting his signature to the instrument, must have either express or implied authority to enter, for his principal who must be *sui juris*, into the particular contract. The authority of an agent to make, draw, accept or endorse notes and bills depends on the general law of agency and is a question of fact. From a perusal of Sections 27 and 28 it is, however,

evident that a general authority to transact business and to discharge debt does not confer upon an agent the power to endorse bills of exchange so as to bind his principal; nor can an agent escape personal liability unless he indicates that he signs as an agent and does not intend to incur personal liability [*Parmode Kumar Pate vs. Damodar Sahu I.L.R. (1953) Cuttack 221*].

*The essentials of a valid acceptance are as follows:*

- (a) *Acceptance must be written:* The drawee may use any appropriate word to convey his assent. It may be sufficient acceptance even if just a bare signature is put without additional words. But it should be remembered that an oral acceptance is not valid in law. However, oral acceptance may be sufficient only in the case of hundies and that too only if a special custom is proved to exist.
- (b) *Acceptance must be signed:* A mere signature would be sufficient for the purpose. Alternatively, the words 'accepted' may be written across the face of the bill with a signature underneath; if it is not so signed, it would not be an acceptance.
- (c) *Acceptance must be on the bill:* That the acceptance should be on the face of the bill is not necessary; an acceptance written on the back of a bill has been held to be sufficient in law. What is essential is that it must be written on the bill; else it creates no liability as acceptor on the part of the person who signs it. Now what will happen if acceptance is signed upon a copy of the bill and the copy is not one of the part of it or if acceptance is made on a paper attached to the bill; in either of the cases, acceptance would not be sufficient.
- (d) *Acceptance must be completed by delivery:* It would not complete and the drawee would not be bound until the drawee has either actually delivered the accepted bill to the holder or tendered notice of such acceptance to the holder of the bill or some person on his behalf.

Where a bill is drawn in sets, the acceptance should be put on one part only. Where the drawee signs his acceptance on two or more parts, he may become liable on each of them separately.

- (e) *Acceptance may be either general or qualified.* By a general acceptance, the acceptor assents without qualification to the order of the drawer. The acceptance of a bill is said to be qualified, when the drawee does not accept it according to the apparent tenor of the bill but attaches some conditions or qualification which have the effect of either reducing his (acceptor's) liability or acceptance of the liability subject to certain conditions. The holder of a bill is entitled to require an absolute and unconditional acceptance as well as to treat it as dishonoured, if it is not so accepted. However he may agree to qualified acceptance, but he does so at his own peril, since thereby he discharges all parties prior to himself, unless he has obtained their consent.

According to the *Explanation* to Section 86 of the Act, an acceptance to be treated as qualified.

- (1) Where it is *conditional*, declaring the payment to be dependent on the happening of an event therein stated, e.g., "accepted payable when in funds" (*Julian vs. Shobrooke* (1753, 2 Wills, 9) "accepted payable in giving up bills of lading for 76 bags of cloves per ship A at the L&W Bank" [*Smith vs. Vertue* (1860) 30 LJCP] "accepted payable when a cargo consigned to me is sold" (*Smith vs. Abbot*);
- (2) When it is partial i.e., when it *undertakes to pay part only* of the sum ordered to be paid by the drawer, e.g., a bill drawn for ₹ 5,000 but "accepted for ₹ 4,000 only".
- (3) When it is *qualified as to locality*, i.e., when it is to pay only at a particular place, or to pay at a place different from the place mentioned in the instrument, and there only. When no place of payment being specified on the order, if the acceptance makes the money payable at a particular place, it is treated as a general acceptance; but where it expressly states that the bill will be paid at the place noted in the acceptance and not otherwise or elsewhere, it amounts to a conditional acceptance. For example, "accepted payable at the Diwala Bank". This is general acceptance, whereas "acceptance payable at the Diwala Bank and not elsewhere" is an instance of qualified acceptance.
- (4) Where it undertakes the payment at a time other than that at which under the order it would be legally due e.g., a bill drawn "payable three months after date" is accepted as "accepted, payable six months after date."

The aforementioned list of *examples* is only illustrative of the different respects in which the bill may be qualified, for it is possible to qualify the acceptance of a bill in other ways as well.

- (v) *Drawee in case of need: As per section 7, When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to be resorted to in case of need, such person is called a "drawee in case of need". Such a person is resorted to in the event of the bill being dishonoured by non-acceptance or non-payment. According to section 115, the bill will not be considered to be dishonoured until it has been dishonoured by such drawee in case of need. Thus, it is obligatory on the holder to present the bill to such drawee and the non presentation of the bill to such drawee absolves the drawer from liability.*
- (vi) *Payee:* The person named in the instrument, to whom or to whose order the amount of a bill of exchange, cheque or promissory note is directed to be paid is the payee.
- (vii) *Delivery* means transfer of possession from one person to another.
- (viii) *Issue of negotiable instrument* means its first delivery, complete in form, to a person who takes it as a holder.
- (j) *Holder, Holder for value and Holder in due course:* (Sections 8 & 9): (i) "Holder" of a negotiable instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto. In other words, holder means the payee or endorsee of a bill of exchange, cheque, or promissory

note, who is in possession of it. The finder of a lost instrument payable to bearer, or a person in wrongful possession of such instrument, is not a holder.

- (ii) "Holder for value" means, as regards all parties prior to himself, a holder of an instrument for which value has at any time been given.
  - (iii) "Holder in due course", in the case of an instrument payable to bearer means any person who, for consideration became its possessor before the amount mentioned in it became payable. In the case of an instrument payable to order, "holder in due course" means any person who became the payee or endorsee of the instrument before the amount mentioned in it became payable to order. In both the case, he must receive the instrument without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title. In other words, holder in due course means a holder who takes the instrument *bona fide* for value before it is overdue, and without any notice of defects in the title of the person, who transferred it to him. Thus a person who claims to be 'holder in due course' is required to prove that: (1) on paying a valuable consideration, he became either the possessor of the instrument if payable to bearer, or endorsees thereof, if payable to order; (2) he had come into the possession of the instrument before the amount due thereunder became actually payable; and (3) he acted in good faith and (4) he had come to possess the instrument without having sufficient cause to believe that any defect existed in the title of transferor from whom he derived his title (Section 9)
- (k) Privileges of a "holder in due course":
- (i) In case of Inchoate Instrument: A person signing and delivering to another a stamped but otherwise inchoate instrument is debarred from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him, the stamp being sufficient to cover the amount (Section 20).  
*Example:* A signs his name on a blank but stamped instrument which he gives to B with an authority to fill up as a note for a sum of ₹3000 only. But B fills it for ₹5,000. B then transfers it to C for a consideration of ₹ 5000 who takes it in good faith. Here in the case, C is entitled to recover the full amount of the instrument because he is a holder in due course whereas B, being a holder cannot recover the amount because he filled in the amount in excess of his authority.
  - (ii) In case of fictitious bill: In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for acceptor to allege as against the holder in due course that such name is fictitious (Section 42).
  - (iii) In case of conditional instrument or 'escrow': In case a bill or note is negotiated to a holder in due course, the other parties to the bill or note cannot avoid liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 46 and 47).



- (iv) In case of instrument obtained by unlawful means or for unlawful consideration; The person liable in a negotiable instrument cannot set up against the holder in due course the defences that the instrument had been lost or obtained from the former by means of an offence or fraud or for an unlawful consideration (Section 58).
- (v) In case original validity of the instrument is denied; No maker of a promissory note, and no drawer of a bill or cheque and no acceptor of a bill for the honour of the drawer shall, in a suit thereon by a holder in due course be permitted to deny the validity of the instrument as originally made or drawn (Section 120).
- (vi) In case Payee's capacity to indorse is denied: No maker of a promissory note and no acceptor of a bill payable to order shall, in a suit thereon by a holder in due course, be permitted to deny the payee's capacity, at the date of the note or bill, to endorse the same (Section 121). In short, a holder in due course gets a good title to the bill.
- (l) Distinction between a holder and a holder in due course:
  - (i) On the basis of consideration: A holder may become the possessor or payee of an instrument even without consideration, whereas a holder in due course is one who acquires possession for consideration.
  - (ii) A holder in due course as against a holder, must become the possessor payee of the instrument before the amount thereon become payable.
  - (iii) on the basis of good faith: A holder in due course as against a holder, must have become the payee of the instrument in good faith *i.e.*, without having sufficient cause to believe that any defect existed in the transferor's title.
  - (iv) On the basis of better title than transferor: A holder can never get a better title than that of the transferor whereas holder in due course can acquire a better title than that of the transferor.
- (m) Negotiation, endorsement, etc. (Sections 14 & 15)
  - (i) Negotiation means the transfer of an instrument for value to a person who, thereupon, become entitled to hold in and sue thereon in his own name.
  - (ii) Under section 15, endorsement can be made only by the holder or maker signing otherwise than as such maker *i.e.* in a different capacity only for the purpose of negotiation. Endorsement denotes appropriate writing on the back *or face or on a slip of paper annexed thereto or signing for the same purpose a stamped paper*, of an instrument so as to transfer the right, title and interest therein to some other person. For the purpose, no particular form is necessary. For *example*, X, who is the holder of a negotiable instrument writes on the back thereof: "pay to Y or order" and signs the instrument. In such a case, X is deemed to have endorsed the instrument to Y. If X delivers the instrument to Y, X ceases to be the holder and Y becomes the holder.
  - (iii) Bearer means the person in possession of an instrument which is payable to bearer.

- (iv) Instrument, being chaos, in action, are assignable without endorsement but the assignee only acquires the rights of the assignor.
- (n) **Payment in due course (Section 10):** Under Section 10 of the Negotiable Instruments Act, "payment in due course" means payment in accordance with the apparent tenor of the instrument in good faith and without negligence to any person in possession thereof under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned. In order that such payment may operate as a discharge of a negotiable instrument, it must fulfil the following conditions.
  - (i) That the payment should be in accordance with the apparent tenor of the instrument. The connotation of the expression 'apparent tenors' is "in accordance with what appears on the face of the instrument to be the intention of the parties. Consequently, it is imperative that the payment should be made at or after maturity. A payment before maturity is not a payment in accordance with the apparent tenor of the instrument; and as such it is not a payment in due course. Further, for the purpose of Section 10, such payment should be made in money only, because the instrument expressed to be payable in money. A different form of payment may however be adopted but only with the consent of the holder of the instrument.
  - (ii) That the person to whom payment is made should be in possession of the instrument. Therefore, payment must be made to the "holder" or a person authorised to receive payment on his behalf. Suppose, the instrument is payable to a particular person or order and is not endorsed by him. Payment to any person in actual possession of the instrument in such case, will not amount to payment in due course. However, in the event of the instrument being payable to bearer or endorsed in blank the payment to a person who possesses the instrument is, in the absence of suspicious circumstances, payment in due course. Any party to a bill, but not any stranger, may pay it; and on payment, such party acquires the rights of the holder against all parties prior to him. But a stranger may pay *supra protest* and for honour of some party to the bill or note.
  - (iii) That the payment should be made in good faith, without negligence, and under circumstances which do not afford a reasonable ground for believing that the person to whom it is made is not entitled to receive the amount. If suspicious circumstances are there, then person making the payment is to at once put on an enquiry. If he does not make the enquiry, and negligently makes payment, that payment would be out of due course and liable to pay again to the real holder for value.

## 2.5 Classification of Instruments

- (a) *Bearer and Order instruments:* An instrument may be made payable: (1) to bearer; (2) to a specified person or to his order. (Section 13)

An instrument is payable to bearer which is expressed to be so payable on which is expressed 'thus "Pay to R or bearer"'. It is also payable to bearer when *a instrument which is originally payable in order but on which* the only or the last endorsement, is an endorsement in blank. (Section 13) Explanation (ii)

An instrument is payable to order, (1) when it is payable to the order of a specified person or (2) when it is payable to a specified person or his order or, (3) when it is payable to a specified person without the addition of the words “or his order” and does not contain words prohibiting transfer or indicating an intention that it should not be transferable. When an instrument, either originally or by endorsement, is made payable to the order of a specified person and not to him or his order, it is payable to him or his order, at his option. (Section 13) Explanation (i) & (iii).

When an instrument is not payable to bearer, the payee must be indicated with reasonable certainty.

**Significance of bearer instruments:** The expression “bearer instrument” signifies an instrument, be it a promissory note, bill of exchange or a cheque, which is expressed to be so payable or on which the last endorsement is in blank (*Explanation 2* to Section 13 of the Negotiable Instruments Act, 1881).

Under Section 46, where an instrument is made payable to bearer it is transferable merely by delivery, *i.e.*, without any further endorsement thereon. This character of the instrument, however, can be altered subsequently. For Section 49 provides that a holder of negotiable instrument endorsed in blank (*i.e.*, bearer) may, without signing his own name, by writing above the endorser’s signatures, direct that the payment of the instrument be made to another person. An endorsee thus, can convert an endorsement in blank into an endorsement in full. In such a case, the holder of the instrument would not be able to negotiate the instrument by mere delivery. He will be required to endorse the instrument before delivering it.

In the case of a cheque, however the law is a little different from the one stated above. According to the provisions of Section 85(2) where a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, despite any endorsement whether in blank or full appearing thereon notwithstanding that any such instrument purported to restrict or exclude further negotiation. In other words, the original character of the cheque is not altered so far as the paying bank is concerned, provided the payment is made in due course. Hence, the proposition that “once a bearer instrument always a bearer instrument”.

*[Note: Section 31 of Reserve Bank of India Act imposes certain restrictions on the issue of Promissory notes and bills of exchange. Even though Section 4 & 13 of the Negotiable Instruments Act permit the issue of bearer promissory notes, the same is not possible under Section 31(2) of the Reserve Bank of India Act. In case of bill of exchange payable to bearer, the acceptance of the same by the drawee would mean that the acceptor agrees to pay to the bearer on demand the sum of money mentioned in the bill and such a thing is prohibited by the Reserve Bank of India Act. Thus, a bill if payable on demand should be an order one and not bearer.]*

(b) *Inland and foreign instrument (Sections 11 & 12):* A promissory note, bill of exchange or cheque drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be an inland instrument.

*Examples:* (i) A promissory note made in Chennai and payable in Delhi.

(ii) A bill drawn in Pune on a person resident in Jaipur (although it is stated to be payable in London)

Any such instrument, not so drawn, made or payable shall be deemed to be a foreign instrument.

*Examples:*(i) A promissory note made in India but made payable in England .

(ii) A bill drawn in England and payable in Paris although it may have been endorsed in India.

Thus, the foreign bills are:

- (i) bills drawn outside India and made payable in or drawn upon any person resident in any country outside India;
- (ii) bills drawn outside India and made payable in India, or drawn upon any person resident in India;
- (iii) bills drawn in India made payable outside India or drawn upon any resident outside India, but not made payable in India.

In the absence of a contract to the contrary, the liability of the maker or drawer of a foreign promissory note or bill of exchange or cheque is regulated in all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and endorser by the law of the place where the instrument is made payable (Section 134). For *example*, a bill of exchange is drawn by A in California where the rate of interest is 25% and accepted by B payable in Washington where the rate of interest is 6%. The bill is endorsed in India and is dishonoured. An action on the bill is brought against B in India. He is liable to pay interest at the rate of 6% only. But if A is charged as drawer, he is liable to pay interest at 25%.

The *distinction between inland and foreign bills* is of importance in connection with Sections 104 and 134 of the Act. Inland bills need not be protested for dishonour; protest in this case is optional. But foreign bills must be protested when law of the place of making or drawing them requires such protest. The question by what law are the contracts on negotiable instruments governed is also important. Principle of *Lex loci contractus* governs the liabilities of the drawer or maker and the form of the instrument.

N.B. According to section 104, foreign bills must be protested for dishonour if the law of the place where these are drawn prescribes for such a protest. In the case of inland bills, protest is optional. .

(c) *Ambiguous and inchoate bills:* According to section 17, an ambiguous bill means an instrument which can be construed either as a promissory note or as bill of exchange ( *e.g.*, a bill drawn by a person on himself in favour of a third person or where the drawee is a fictitious person), *at the selection of the holder and the instrument shall be thenceforward be treated accordingly*. The law on the point is that the holder of such a bill is at liberty to treat the instrument as bill or a promissory note. The nature of the instrument will be as determined by the holder.

In the following cases *an instrument may be treated as an ambiguous instrument*, where the holder may treat the instrument either as a bill of exchange or as a promissory note.:

- (i) Where the drawer and the drawee of a bill are the same person
- (ii) Where the drawee of a bill is a fictitious person.
- (iii) Where the drawee of a bill is a person not having capacity to contract.
- (iv) *Where an instrument is made in terms or in form so ambiguous that it is doubtful whether it is a bill of exchange or a promissory note.*

An incomplete instrument called an inchoate instrument. Section 20 of the Negotiable Instruments Act provides that when one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby give *prima facie* authority to the holder thereof to make to complete, as the case may be, upon it a negotiable instrument for an amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument in the capacity in which he signed the same, to any holder in due course for such amount. Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended to be paid by them there under. The principle of this rule (namely that a person who gives another possession to his signature on a blank stamped paper, *prima facie* authorises the latter as his agent to fill it up and give to the world the instrument as accepted by him) is one of estoppel. By such signature he binds himself as drawer, maker, acceptor or endorser. His signature on the blank paper purports to be an authority to the holder to fill up the blank, and complete the paper as a negotiable instrument. Till this filling in and completion, the instrument is not a valid negotiable instrument, and no action is maintainable on it. *Example*, a person signed a blank acceptance and kept it in his drawer and some person stole it and filled it up for ₹ 2000 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument (*Baxendale vs Bennett*). Further, as a condition of liability, the signer as a maker, drawer, endorser or acceptor must deliver the instrument to another. In the absence of delivery, the signer is not liable. Furthermore, the paper so signed and delivered must be stamped in accordance with the law prevalent at the time of signing and on delivering otherwise the signer is not estopped from showing that the instrument was filled without his authority.

#### Key points

- ◆ A bearer instrument is one which is expressed to be payable to its bearer or which has last endorsement in blank.
- ◆ An instrument payable to order is the one which is expressed to be payable to a particular person.

- ◆ A negotiable instrument drawn or made in India and made payable in, or drawn upon any person resident in India shall be deemed to be inland instrument.
- ◆ Any instrument which is not an inland instrument is a foreign instrument.
- ◆ When the nature of an instrument is not clear, it is termed as ambiguous instrument. There such an instrument may be treated as either promissory or as a bill of exchange.
- ◆ Inchoate instrument is an instrument that is signed and duly stamped but otherwise wholly or partially blank.

## 2.6 Sight and Time Bills etc. (Sections 21 To 25)

(i) *Instruments payable on demand:* Bills and notes are payable either on demand or at a fixed future time. Cheques are always payable on demand. A promissory note or bill of exchange in which no time for payment is mentioned is payable on demand. A bill or promissory note is also payable on demand when it is expressed to be payable on demand, or “at sight” or “presentment”. It should be noted that the expression “on demand” does not imply that any actual demand is to be made; it is only a technical expression meaning “immediately payable”. Such a bill or note may be presented for payment at any time at the option of holder, but it must be presented within a reasonable time after its issue in order to tender the drawer liable, and within a reasonable time after its endorsement to render the endorser liable.

An instrument payable on demand would be overdue when it remains in circulation for an unreasonable length of time.

(ii) *Time Bills:* The expression “after sight” means, a promissory note after presentment for sight, and in a bill of exchange, after acceptance, noting for non-acceptance or protest for non-acceptance. It is useful to make a bill or not payable at so many months or days after sight.

The term ‘after sight’ is differently used in a note and a bill. In the former case, it denotes that payment is not to be demanded till it has been exhibited to the maker, for a note is incapable of being accepted; while in the latter case, it denotes that sight must appear in legal way, i.e., after acceptance, if the bill has been accepted, or after noting for non-acceptance or protest for non-acceptance [*Homes vs. Kerisson*(1810)].

(iii) *Maturity:* Where bill or note is payable at fixed period after sight, the question of maturity becomes important. The maturity of a note or bill is the date on which it falls due. A note or bill, which is not expressed to be payable on demand, at sight or on presentment; is at maturity on the third day after the day on which it is expressed to be payable. Three days are allowed as days of grace. No days of grace are allowed in the case of a note or bill payable on demand, at sight, on presentment.(Section 22)

(iv) *Calculation of maturity:*

(a) Where a bill is payable at a fixed period after sight, the time is to be calculated from the

date of acceptance if the bill is accepted and from the date of noting or protest if the bill is noted or protested for non-acceptance (For the explanation of noting and protesting, read Sections 99 and 100 of the Negotiable Instruments Act, 1881).

In the case of a note, the expression "after sight" means after exhibition thereof to maker for the purpose of founding a claim for payment.

(b) In the case of a bill payable after a stipulated number of months after sight which has been accepted for honour, the date of its maturity is calculated from the date of acceptance for honour.

*Acceptance for honour (sections 108): It is an unusual kind of acceptance done by any person not being a party already liable thereon bill, to accept the bill for the honour of any party thereto. This acceptance by such party is allowed when the original drawee refuses to accept or refuses to give better security when demanded by the notary. Such a bill is kept until its maturity and the holder is given an additional person whom the holder may fall back upon if the bill is not paid when due.*

(c) *According to section 24, in calculating the date at which a note or bill made payable at certain number of days after date or after sight or after certain event is at maturity,; the day of the date, or of presentment for acceptance or sight, or of protest for non-acceptance, or on which the event happens, shall not be included.*

(d) According to section 23:

- When a note or bill is made payable, a stated number of months after date, the period stated terminates on the day of the month which corresponds with the day on which the instrument is dated.
- When it is made payable after a stated number of months after sight the period terminates on the day on the month which corresponds with the day on which it is presented for acceptance or sight or noted for non-acceptance or protested for non-acceptance.
- When it is payable a stated number of months after a certain event, the period terminates on the day of the month which corresponds with the day on which the event happens.
- If the month in which the period would terminate has no corresponding day, the period terminates on the last day of such month.
- Three days of grace are allowed to these instruments after the day on which they are expressed to be payable (Section 22).

According to section 25, when the day on which a note, or bill is at maturity is a public holiday, the instrument shall be deemed to be due and payable on the next preceding business day.

**Key points**

- ◆ “At sight”, “on presentment”, expressions in reference to promissory note or bill of exchange means on demand. Whereas expression “After sight” in a case of promissory note means after presentment for sight and in reference to bill of exchange means after acceptance/noting/protest for non-acceptance.
- ◆ Time bills is an instrument not payable on demand. It contains the time or day for payment for any day after its execution.
- ◆ Maturity is the date of any instrument at which its payment becomes due. Any instruments are at maturity on the third day after the day on which it is expressed to be payable.

## 2.7 Negotiation, Negotiability, Assignability

*Negotiation:* According to section 14, when a negotiable instrument is transferred to any person with a view to constitute the person holder thereof, the instrument is deemed to have been negotiated. A negotiable instrument may be transferred in either of the two ways, viz., (1) by negotiation under the Negotiable Instruments Act, 1881 (Sections 14, 46, 47, 48); and (2) by assignment of the instrument under the Transfer of Property Act, 1882 (Chapter VII, Section 130). Transfer by negotiation, however, is the only mode of transfer recognised by the Act.

Under the Act, negotiable instruments may be negotiated either by delivery when these are payable to bearer or by endorsement and delivery when these are payable to order. *Some important points with respect to negotiation are:*

(i) *Importance of delivery (Section 46):* Delivery is an incident of the utmost importance in the case of an instrument. It is essential to the issue of an ‘instrument’; for “issue” means the delivery of the instrument, complete in form, to a person who takes it as a holder. It is equally essential to the negotiation of an instrument, for a bearer instrument, must be transferred by delivery and in the case of any other instrument, endorsement is incomplete without delivery. In fact, a negotiable instrument is nothing but a contract which is incomplete and revocable until the delivery of the instrument is made. For *instance*, in the case of a promissory note so long as the note, remains with the maker, the payee cannot claim payment; it is the delivery of the note to the payee that entitles him to claim payment; Section 46 of the Act provides as follows:

“The making, acceptance or endorsement of promissory note, bill of exchange or cheque is completed by delivery, actual or constructive”.

(ii) *How to deliver:* As between parties standing in immediate relation, delivery to be effectual, must be made by the party making, accepting or endorsing the instrument, or by a person authorised by him in this behalf. Thus a promissory note must be handed over to the payee by the maker himself or by someone authorised by the maker. Similarly, a bill of exchange must be delivered to the transferee by the maker, acceptor or endorser, as a case may be.



(iii) *Conditional and unconditional delivery*: An instrument may be delivered conditionally or only for a special purpose, and not for the purpose of transferring absolutely the property in the instrument. A bill delivered conditionally is called an 'escrow'. Although a conditional delivery is valid, the condition attaches exclusively to the delivery and not to the making or drawing of an instrument. A bill must be drawn and a note made unconditionally. When an instrument is delivered conditional or for special purpose, the property in the instrument does not pass on to the transferee until the condition is fulfilled and the transferee holds such instrument in law as trustee or agent of the transferor.

*Example*: If, an instrument delivered conditionally to X is transferred by him for value to Y without notice of the condition, Y can claim payment even if the condition is not complied with. The reason is obvious - Y is *bona fide* transferee for value without notice of the condition and, as such, he should not suffer for suppression of fact by X.

(iv) *Negotiation by delivery (Section 47)*: An instrument payable to bearer is negotiable by delivery thereof. But when such instrument is delivered on condition that it is not to take effect except in certain event, it is not negotiable (except in the hands of a holder for value without notice of the condition) unless such event happens.

The distinction between 'delivery' and 'negotiation' should be noticed. An instrument is said to be negotiated, when it is transferred from one person to another in such a manner as to constitute the transferee the holder thereof.

(v) *Negotiation by endorsement*: In order to negotiate, that is to transfer title to an instrument payable to order, it is at first to be endorsed and then delivered by the holder.

The endorsement consists of the signature of the holder made on the back of the negotiable instrument with the object of transferring the instrument. If there is no space on the instrument, the endorsement may be made on a slip of paper attached to it. This attachment is known as "Allonge" and it then becomes part of the bill.

According to Section 15 of the Negotiable Instruments Act, 1881 "when the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to endorse the same, and is called the endorser."

(vi) *Different types of endorsements*;

(a) *Blank (or general)*: No endorsee is specified in an endorsement in blank, it contains only the bare signature of the endorser. A bill so endorsed becomes payable to bearer.

*SPECIMEN*

*Motilal Poddar*

(b) *Special (or in full)*: In such an endorsement, in addition to the signature of the endorser the person to whom or to whose order the instrument is payable is specified.

*SPECIMEN*

Pay to B, Batliwala or order.

*S. Shroff*

- (c) *Restrictive*: Such an endorsement has the effect of restricting further negotiation and transfer of the instrument.

*SPECIMEN*: (1) Pay to A only *S. Mukerjee*  
(2) For the account of A only *N. Aiyar*

- (d) *Conditional or qualified endorsement*: Such an endorsement combines an order to pay with condition.

*SPECIMEN*: Pay to A on safe receipt of goods.

*V. Chopra*

- (e) *Sans Recourse*: By adding these words after the endorsement, the endorser declines to accept any liability on the instrument of any subsequent party.

Sometimes, where an endorser who so excludes his liability as an endorser afterword becomes the holder of the same instrument. In such a case, all intermediate endorsers are liable to him.

**Example:** M, the holder of a bill, endorses it "without recourse" to N. N endorses it to P, P to Q, Q to R and R endorses it again to M. M can recover the amount of the bill from N, P, Q, and R, or any of them. Thus, M is not only reinstated in his former rights, but has the right of an endorsee against N, P, Q and R.

- (f) *Sans Frais*: These words when added at the end of the endorsement, indicate that no expenses should be incurred on account of the bill.
- (g) *Facultative*: When it is desired to waive certain right, the appropriate words are added to indicate the fact, *e.g.*, "notice of dishonour dispensed with".

Every endorser of a negotiable instrument is liable, under Section 35, to every subsequent party to it provided due notice of dishonour is given to or received by him *e.g.*, if a bill is drawn by A upon B and is payable to C or order, and C endorses the bill to D, who in turn endorses it to E, then, in case B, dishonours the bill, the holder, *i.e.*, E has the right of action against all the parties *i.e.*, D, C, and A. Similarly, D has right against C and A. To this rule that every prior party of a bill is liable to every subsequent party, there are a few exceptions which are enumerated below:

- (1) Any endorser can exclude personal liability by endorsing "sans recourse" *i.e.* without recourse.
- (2) If the holder of a negotiable instrument, without the consent of the endorser destroys the instrument or in any way prejudices the holder (*Section 40*).

- (3) The rule is not applicable also in the case of “circuit of action” - *e.g.*, a bill is drawn by A upon B payable to C or order, who endorses it to D who endorses it to E, who endorses it to F, who endorses it to G and who again, endorses it back to D. In that case, it will be observed that a circle is complete between the first and second holdings of D; and the parties in between (*i.e.*, E, F and G) are absolved from liability to D because D is, as against them, both a subsequent party and a prior party. If, however, D’s first endorsement was “sans recourse”, the intermediate parties, *i.e.*, E, F and G would not be absolved from liability to him.

*Example:* M drew a cheque amounting to ₹ 2 lakh payable to N and subsequently delivered to him. After receipt of cheque N endorsed the same to C but kept it in his safe locker. After sometime, N died, and C found the cheque in N’s safe locker. Does this amount to Endorsement under the Negotiable Instruments Act, 1881?

No, C does not become the holder of the cheque as the negotiation was not completed by delivery of the cheque to him. (Section 48, the Negotiable Instruments Act, 1881)

(vii) *Conversion of endorsement in blank into endorsement in full (Section 49):* The holder of a negotiable instrument endorsed in blank may, without signing his own name by writing above the endorser’s signature, a direction to pay to any other person as endorsee, convert the endorsement in blank into an endorsement in full; and the holder does not thereby incur the responsibility of an endorser, for his name appears nowhere in the instrument. The advantage of such course is that the holder, though he transfers the instrument, does not incur the responsibility of an endorser (*Hirschfeld vs. Smith* (1866) L.R.I. C.P. 340).

(viii) *Effect of endorsement (Section 50):*

- (a) The endorsement of an instrument, followed by delivery, transfers to the endorsee the property in the instrument with the right of further negotiation. That is, the endorsee may endorse it to some other person.
- (b) The endorsement may also contain express terms making it restrictive. The effect of restrictive endorsement is (1) to prohibit or exclude the right of further negotiation, or (2) to constitute the endorsee an agent to endorse the instrument; or (3) to entitle the endorsee to receive the contents of the instrument for the endorser or for some other specified person.
- (c) *A restrictive endorsement gives the endorsee:* (1) the right to receive payment of the instrument; (2) the same rights of action against any other party to the instrument as the endorser had; (3) power, only in accordance with the express terms of his authority, to transfer the instruments and his right thereon to another.
- (ix) *Who may negotiate (Section 51):* The following persons may negotiate an instrument: (1) sole maker, (2) drawer, (3) payee, (4) endorsee or all of several joint makers, drawers, payees or endorsees.

The case of a maker or drawer endorsing an instrument can occur only when the instrument is drawn to his own order. When the endorsee is the holder under a restrictive

endorsement, he must exercise his power of negotiation strictly in accordance with the express terms of his authority. Thus, if negotiability is excluded by the respective endorsement, the endorsee, as holder, cannot negotiate.

The explanation to Section 51 provides that though a maker or a drawer may endorse or negotiate an instrument, he cannot do so, unless the instrument falls into his possession in a lawful manner or unless he is the holder thereof. Further, insofar as the payee or an endorsee is concerned, he must before he can negotiate the instrument, be a holder thereof. Consequently, a person who steals or endorses or finds a lost instrument, cannot endorse or negotiate, as he is not a holder within the meanings of the Act.

(x) *Exclusion of liability of endorser (Section 52)*: The endorser of an instrument may, by express words in the endorsement, exclude his own liability on the instrument. When an endorser signs his name, adding the words “without recourse”, he incurs no liability. The holder cannot claim compensation from him in case of dishonoured by the drawee, acceptor or maker. But for the words “without recourse”, he would have been liable.

*The Act gives power to an endorser to insert by express words in the endorsement a stipulation negating or limiting his own liability to the holder.* Thus, he may either (1) make his liability depend upon the happening of a specified uncertain event, (2) make the right of the endorsee to receive the amount mentioned in the instrument depend upon a specified uncertain event or on the fulfillment of some condition.

But when such endorser afterwards becomes the holder, all intermediate endorsers are liable to him. For *example*, A the payee and holder of an instrument endorses it to B with the words “without recourse” and B endorses it to C who in his turn endorses it to A; B and C are liable to A as intermediate endorsers *and also A has reinstated in his former rights*.

(xi) *Holder deriving title from holder in due course (Section 53)*: A holder of an instrument deriving title from a holder in due course has rights thereon of that holder in due course. It is not imperative for a holder with derivative title to give consideration for the title. Thus, a holder can maintain a suit upon the bill in his own name as he has derived the title from the holder in due course.. It has been held that a title, which has been cleansed of defects by passing through the hands of a holder in due course remains immune from those defects inspite of the fact that a subsequent holder may have noticed that the defects once existed provided he was not a party to them [*Guildeford Trust Vs. Goss* [1927] 43 LR 167; *Credit Bank Vs. Schenkers* [1927] WN 39].

For *example*, X obtains Y’s acceptance to a bill by fraud. X endorses it to Z who takes it as a holder in due course. Z endorses the bill to F who knows of the fraud. Since F derives the title from Z who is a holder in due course and F is not party to fraud, F gets a good title to the bill.

(xii) *Effect of endorsement in full after a blank one (Sections 54 and 55)*: An instrument endorsed in blank is payable to the bearer, although originally it *might have been* payable to order. If an instrument after having been endorsed in blank is endorsed in full, the endorsee in full does not incur the liability of an endorser, so the amount of it cannot be claimed from him.

In other words, if an endorsement in blank is followed by an endorsement in full, the instrument still remains payable to bearer and negotiable by delivery as against all parties prior to the endorse in full, though the endorser in full is only liable to a holder who acquired title directly through endorsement and persons deriving title through such holder. For *example*, X is the payee holder of a bill of exchange. X endorses it in blank and delivers it to Y who endorses it in full to Z or order Z. Z without endorsement, transfers the bill to F. In view of Section 55, F as the bearer of the instrument can receive payment or sue the drawer, acceptor or X who endorsed it in blank but he cannot sue Y or Z who is a subsequent but not a prior party. But there is an exception to this rule. The person to whom it has been endorsed in full, or anyone who derives title through him, can claim the amount from the endorser in full.

(xiii) *Effect of endorsement for part of sum due (Section 56)*: An endorsement purporting to transfer only a part of the amount of instrument is invalid, and the endorsee, therefore cannot negotiate it. But when the amount due has been paid in part, a note to that effect may be endorsed on instrument and the instrument may then be negotiated for the balance.

#### Key points

- ◆ Negotiation means transfer of a negotiable instrument by one person to another in order to make the transferee the holder of the instrument.
- ◆ Negotiation may be made by delivery or by endorsement and delivery.
- ◆ Assignment of a negotiable instrument means transfer of ownership of the instrument from one person (assignor) to another (assignee), whereby the assignee becomes entitled to recover the amount due on the instrument from the parties liable to pay.

## 2.8 Negotiability vs. Assignability

- (i) The essential distinction between transfer by negotiation and transfer by assignment is that in the latter case, the assignee does not acquire the right of a holder in due course but has only the right, title and interest of his assignor; on the other hand in the former case he acquires all the rights of a holder in due course *i.e.*, rights from equities (*Mohammad Khunerali vs. Ranga Rao*, 24 M. 654).
- (ii) In the case of negotiable instrument, notice of transfer is not necessary while in the case of an assignment of chose in action, notice of assignment must be served by the assignee on his debtor.
- (iii) Again, in the case of transfer of negotiable instrument, consideration is presumed, but in the case of transfer by assignment, consideration must be proved as in the case of any other contract.
- (iv) Negotiation requires either delivery only in the case of “bearer” instrument, or indorsement and delivery only in the case of “order instrument”. But assignment of an instrument according to Section 130 of the Transfer of Property Act, 1882 has to be made

by a written document and signed by the transferor and this procedure is required both in respect of bearer and order instruments.

- (v) Indorsement do not require payment of stamp duty whereas an assignment under Section 130 of the Transfer of Property Act requires payment of stamp duty.

## 2.9 Different Provisions relating to Negotiation

(a) **Negotiation Back:** An instrument is said to have been negotiated back to him and he is said to have taken up or taken back the negotiable instrument when a person who has been a party to the negotiable instrument takes it again. For *example*, suppose that the endorsements on a negotiable instrument are as under:

P  
A  
B  
X  
Y  
A

Here A is person who is a prior party to the instrument. He negotiated it to B, B to X, X to Y and Y again to this very A. On account of this last endorsement, A should have right to claim money from X, Y and B. The rule is that every prior party is liable to every subsequent party. Thus, conversely, every subsequent party may sue every prior party. As a result of the prior party (*i.e.*, A) having taken back the instrument subsequently, he (*i.e.*, A) becomes a 'subsequent' party. Therefore A, by reason of the last endorsement mentioned above, comes to have the rights to claim money from Y, X or B. A is permitted by law to sue Y, X or B then Y, X or B in his turn can sue A because of A's prior endorsement. This will lead to a circuitry of action. To prevent this, Section 52 of the Negotiable Instruments Act enacts an exception to the general rule to provide that the holder in due course of a negotiable instrument may sue all prior parties thereto. Thus A, in the above case cannot sue Y, X or B. But A can sue P since the latter is prior to A's original endorsement. If however A, in original endorsement, had signed "sans recourse" there could be no circuitry of action and A could sue Y, X or B.

(b) **Capacity to incur liability under instrument (Section 26):** Every person competent to contract (*according to the law to which he is subject*) has capacity to bind himself and be bound by the making, drawing, accepting, endorsing, delivering and negotiating an instrument.

A party having such capacity may himself put his signature or authorize some other person to do so.

*A minor may draw, indorse, deliver and negotiate an instrument so as to bind all the parties except himself. A minor may be the drawer where the instrument is drawn or endorsed by him. In that case he does not incur any liability himself although other parties to the instrument can be made liable and the holder can receive payment from any other party thereto.*

*Authority to sign (Sections 27 & 28):* Every person, capable of incurring liability, may bind himself or be bound by a duly authorized agent acting in his name.

A general authority *given to an agent* to transact business *and to receive and discharge debts* does not empower him to accept or endorse bills of exchange so as to bind his principal.

An agent may have authority to draw bills of exchange, but not endorse them. An authority to draw does not, necessarily, imply an authority to endorse.

An agent, who signs his name on an instrument without indicating thereon that he signs as agent, *and that he does not intend thereby to incur personal responsibility*, is personally liable, but this rule does not apply where anyone induces him to sign upon the belief that principal only would be held liable.

*An agent can be sued by the holder in an action for falsely representing that he had authority..*

### (c) Liabilities of parties

(a) *Liability of legal representatives signing (Section 29):* A 'legal representative' of a deceased person, who signs his own name on an instrument, is personally liable for the entire amount; but he may expressly limit his liability to the extent of the assets received by him as legal representative. The term "legal representative" includes heirs, executors and administrators.

(b) *Liability of drawer (Section 30):* The drawer of a bill of exchange or cheque is bound, in the case of dishonour by the drawee or acceptor thereof to compensate the holder, provided due notice of dishonour has been given to, or received by him provided in Sections 93 to 98 of the Act.

The drawer's liability is conditional, *i.e.*, it arises only in the event of a dishonour by the drawee or acceptor. Once there has been dishonour and the notice of dishonour has been served on the drawer, he is bound to compensate the holder whatever be the state of the account between himself and the drawee or acceptor (*Seth Kahandas vs. Dahia 3, Bom. 182*). The holder will have to be compensated, for the principal sum together with interest calculated according to the rules mentioned in Sections 79 & 80 and for the expenses properly incurred by him in presenting noting and protesting the instrument. On dishonour of a bill of exchange by non-acceptance followed by a notice of dishonour to the drawer, the drawer becomes liable immediately for the full amount of the bill. The drawer cannot ask the holder to wait till the date of maturity to see whether it will be dishonoured by non-payment [*Whitehead vs. Walker [1842] 9 M and W 506*]. If however, the holder chooses to wait till its maturity before he sues the drawer he does not acquire a fresh cause of action by reason of its non-payment of the due date.

The only pre-condition of the liability of the drawer is that notice of dishonours should have been received by him, unless the case is one covered by Section 98 (*situations when notice of dishonour is unnecessary*) of the Act and notice of dishonour is dispensed with.

The drawer of a bill or cheque is a “prior party” to the instrument and as such is liable to every holder in due course, under Section 36 of the Act, till the instrument is discharged. According to section 37, until acceptance, *drawer, in the absence of a contract to the contrary*, is liable on the instrument as a principal debtor and *all other parties are liable as surities for the maker, drawer and acceptor, as the case may be*.

Usually, the liability of the drawer of a bill or cheque is secondary and conditional (the liability of the acceptor *and maker* of the bill and drawee of the cheque being primary and unconditional). However, in the case of an accommodation bill drawn for the accommodation of the drawer, in addition to his liability to the payee or holder, the drawer is bound to indemnify the acceptor if he suffers any damage on account of his acceptance.

It should, however, be noted that the liability of a drawer is subject to a contract to the contrary. He may, by an express stipulation in the instrument, limit or exclude his liability.

(c) *Liability of drawee of cheque (Section 31)*: The drawee of the cheque is always a banker. It is the duty of the banker to pay the cheque, provided he has in his hands sufficient fund of the drawer and the funds are properly applicable to such payment.. If the banker refuses payment without sufficient cause being shown, he must compensate the drawer for any loss caused by such improper refusal. The bank is required to compensate, not the holder, but the drawer. The amount of compensation, that the drawee would have to pay to the drawer is to be measured by the loss or damage say loss of credit, suffered by the drawer. The principle is: “The lesser the value of the cheque dishonoured, the greater the damage to the credit of the drawer”. If there is any agreement between the drawer and the banker that the former shall not draw more than one cheque every week, the banker is not bound to pay the second cheque. The banker must pay the cheque, only when he is duly required to do so. If any trustee opens an account, the banker is entitled to refuse to pay cheques drawn for purposes other than those of the trust. *Trust money is not properly applicable to the payment of a cheque drawn in breach of trust*.

In addition to such a general right, a banker will be justified or bound to dishonour a cheque in the following cases, viz.;

- (i) If a cheque is undated [*Griffth vs. Dalton* [1940] 2 K.B. 264].
- (ii) If it is stale, that is if it has not been presented within reasonable period, which is three months (*or a lesser period as prescribed by the drawer*) after its issue..
- (iii) If the instrument is inchoate or not free from reasonable doubt [as per view of Lord Haldan in *London Joint Stock Bank vs. Macmillan and Arthur* (1981) A.C. 777 (814)].
- (iv) If the cheque is post-dated and presented for payment before its ostensible date [*Morley vs. Culverwell* (1840) 7 M. & W. 174, 178].
- (v) If the customer’s funds in the banker’s hands are not ‘properly applicable’ to the payment of cheque drawn by the former. Thus, should the funds in the banker’s hand’s be subject to a lien or should the banker be entitled to a set-off in respect of them, the funds cannot



be said to be “properly applicable” to the payment of the customer’s cheque, and the banker would be justified in refusing payment.

- (vi) If the customer has credit with one branch of a bank and he draws a cheque upon another branch of the same bank in which either he has account or his account is overdrawn [*Woodland & Fear* (1857) 7 E & B 519].
- (vii) If the bankers receive notice of customer’s insolvency [*Mathew vs. Sherwell* (1810), 2 Taunt 439], or lunacy [*Drew vs. Nunn* (1879) 4 Q.B.D. 661].
- (viii) If the customer countermands the payment of cheque for the banker’s duty and authority to pay on a cheque ceases [*Mowji Shamji vs. The National bank of India* 22 Bom. 499]. ***The instructions in case of ‘stop payment’ of cheque should be honoured only if it is properly authorized.***
- (ix) If a garnishee or other legal order from the Court attaching or otherwise dealing with the money in the hand of the banker, is served on the banker [*Rogers vs. Whitely* (1889), 22 Q.B.D. 236, affirmed 1892 A.C. 118].
- (x) *If the authority of the banker to honour a cheque of his customer is undermined by the notice of the latter’s death. However, any payment made prior to the receipt of the notice of death is valid* [*Tata vs. Hilbert* (1793) 2 Ves, 111; *in re Beaumont*, 1 Ch. 889].
- (xi) If notice in respect of closure of the account is served by either party on the other [*Buckingham & Co. vs. London & Midland Bank* (1895) 12 T.L.R. 70].
- (xii) If it contains material alterations, irregular signature or irregular endorsement.
- (d) *Liability of maker of note and acceptor of bill (Section 32):* The maker of a promissory note is bound to pay the amount at maturity, according to the tenor of the note. In default of such payment, the maker is bound to compensate any party to the note for any loss sustained by reason of such default.

Under Section 32, the liability of the drawee only arises when he accepts the bills. In the absence of a contract to the contrary, the acceptor (drawee) of a bill before maturity is bound to pay the amount thereof only at maturity, in accordance with the apparent tenor of the acceptance. In the event of the bill being accepted after maturity, he is bound for the amount to the holder on demand. In default of such payment as aforesaid, he is bound to compensate any party to the bill for any loss or damage caused to him by such a default. There is no provision in the Act that the drawee as such is liable on the instrument, the only exception being under Section 31 in the case of a drawee of cheque (discussed hereinafter) having sufficient funds of the customer in his hands, and even then the liability is towards the drawer and not the payee (*Seth Jagjivan vs. Ranchhoddas* A.I.R. 1954 S.C. 551).

The following persons incur liability by acceptance; (1) drawee (2) person named as drawee in case of need, and (3) acceptor for honour. Where there are several drawees, each can accept only for himself, unless they are partners.

- (e) *Liability of endorser (Section 35):* The endorser of an instrument by endorsing and

delivering the instrument, before maturity, undertakes in effect the responsibility that on the due presentment it shall be accepted, (if a bill), and paid and that if it is dishonoured by the drawee, acceptor or maker, he will indemnify the holder or subsequent endorser who is compelled to pay, provided due notice of dishonour is received by him. But he may insert, in the endorsement, stipulations excluding, or making his liability conditional. In this respect, his position is better than that of a drawer or an acceptor, neither of whom can exclude his liability. An acceptor, however can make his acceptance conditional.

(f) *Liability of parties to holder in due course (Section 36)*: Every prior party (*i.e.*, maker or drawer, acceptor and all intervening endorser) to an instrument is liable to a holder in due course until the instrument is satisfied. Thus prior parties of a note are jointly and severally liable for the payment and may be sued jointly.

(g) *Liability of maker, drawer and acceptor as principals (Sections 37 & 38)*: The maker of a promissory note is liable as the principal debtor. If the payee endorses it to A, the maker will be liable to A as the principal debtor and the payee will be liable as a surety. Similarly, the drawer of a cheque, the drawer of a bill until acceptance and the acceptor are respectively liable as sureties. As between the parties so liable as sureties, each prior party is also liable as a principal debtor in respect of each subsequent party. For instance, A draws a bill payable to his own order on B who accepts it. Afterwards A endorses the bill to C, C to D to E. As between E (holder) and B, B is the principal debtor, and A, C and D are his sureties. As between E and C, C is the principal debtor and D his surety.

(h) *Nature of suretyship (Section 39)*: The holder of an accepted bill may waive his claim against the acceptor, but at the same time, he may expressly reserve his right to charge the other parties. Under Section 134 of the Indian Contract Act, 1872 the release of the principal debtor has the effect of discharging the surety, but in the case of a bill it is not so. But if the holder does not reserve his right expressly against the other parties, they too will be discharged if he releases the acceptor.

(i) *Discharge of endorser's liability (Section 40)*: ***Where the holder of a negotiable instrument, without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity.*** Any party liable on the instrument may be discharged by the intentional cancellation of his signature by the holder. Suppose that A is the holder of a bill of exchange of which B is the payee and it contains the following endorsement in blank:

First endorsement, "B"

Second endorsement, "C"

Third endorsement, "D"

Fourth endorsement, "E"

A, the holder, may intentionally strike out the endorsement by D and C; in that case the liability of D and C upon the bill will come to an end. But if the endorsements of D and C are struck out without the consent of E, A will not be entitled to recover anything from E the reason being that as between D and E, D is the principal debtor and E is surety. If D is released by the

holder under Section 39 of the Act, E, being surety, will be discharged. The rule may be stated thus: when the holder without the consent of the endorser impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder.

(j) *Effect of forged endorsement on acceptor's liability (Section 41):* A bill may be accepted before or after endorsement by the payee. *An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill. Thus, in case of such an acceptance where the acceptor has knowledge or reasons to believe that the endorsement is a forgery, he is not relieved from the liability and has to pay the amount twice, once to the holder, and again to the real owner of the bill or note.*

(k) *Liability of acceptor of a bill drawn in a fictitious name (Section 42):* The acceptor is not relieved from liability by proving that the drawer is fictitious. Suppose X uses a fictitious name in drawing a bill upon Z and that the bill is made payable to the order of the drawer X then endorses the bill in the same fictitious name to Y, who presents the Bill to Z, for acceptance. If Z accepts the bill, in spite of the fact that the name of the drawer is fictitious; he cannot escape liability to pay by showing that the name of the drawer is fictitious; rather he will not be allowed to lead evidence that the name is fictitious.

(l) *Liability on an instrument made drawn etc. without consideration (Section 43):* An instrument made, drawn, accepted, endorsed, or transferred without consideration creates no obligation of payment between the parties to the instrument. For *example*, if a promissory note is delivered by the maker to the payee as a gift, it cannot be enforced against the maker by the payee.

Similarly, if the consideration fails, there is no obligation on the parties to pay. For *example*, X makes a note in favour of Y in anticipation of Y's supplying a bale of cotton. Y fails to deliver the cotton cannot claim payment from X.

Again, a bill that is drawn or accepted without consideration does not impose any liability either on the drawer or on the acceptor to pay the holder. Similarly, if an instrument is endorsed without consideration, nothing can be claimed from the endorser.

But if any party to an instrument made, accepted, endorsed or transferred without any consideration, or for a consideration which fails, has transferred the instrument to a holder for a consideration such holder and every subsequent holder deriving title from him, may recover the amount due on such instrument from the *transferor* for consideration or from any party prior thereto. For *Example*, X and Z are respectively the drawer, the payee and the acceptor of a bill of exchange drawn without consideration; Y transfers the bill to P for consideration. P can claim payment from Y and also from Z and X.

#### Key points

- ◆ Parties to an instruments- Every person capable of contracting may bind himself and be bound by the making/drawing/acceptance/endorsement/delivery and negotiation of an instruments. Minor is an exception binding all the parties except himself.

- ◆ An agent can make, accept or indorse a negotiable instrument only if express authority has been granted to him by his principal.
- ◆ Liabilities of parties- (i) A legal representative of a deceased person is liable personally or expressly limits his liability to the extent of the assets received by him. (ii) Liability of drawer- The drawer is bound to pay the holder in case an instrument is dishonoured. (iii) Liability of drawee of cheque i.e., banker – Where the drawee of cheque or banker is in default of payment though having a sufficient funds of the drawer in hands, is liable to the drawer. (iv) Liability of maker of note and acceptor of bill- The liability of maker of a note is primary and absolute and so liable to pay at its maturity according to apparent tenor of the note whereas the acceptor of a bill is primarily liable to pay the amount thereof according to the apparent tenor of his acceptance. (v) Liability of indorser- Every indorser who indorsed an instrument before its maturity is liable to the parties that are subsequent to him. And his liability arises only if there is a default by the party who is primarily liable to pay the instrument on maturity. (vi) Liability of parties to holder in due course- Every party to an instrument is liable to a holder in due course until the instrument is satisfied (vii) Liability of maker, drawer and acceptor is as principals debtors and others as surities (viii) Nature of suretyship- the holder of an accepted bill may expressly reserve his right to charge the other parties by entering into a contract with the acceptor. (ix) Discharge of indorser's liability- indorser is discharged from liability where the holder of a instrument destroys /impairs the indorser's remedy against a prior party (x) Effect of forged indorsement on acceptor's liability- the acceptor cannot be relieved from the liability knowing that indorsement is forged. (xi) Liability of acceptor of a bill drawn in a fictitious name- Here the acceptor is liable on the bill to a holder in due course (xii) Liability on an instrument made drawn etc. without consideration- Such a instruments creates no obligation of payment between the parties to the transaction.

(d) Dishonoured cheque to be treated as an offence: From 1st April 1989, a person issuing a Cheque will be committing an offence if the cheque is dishonoured for insufficiency of funds. The offence will be punishable with imprisonment for a term up to two years [as prescribed by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002] or with a fine twice the amount of the cheque or both. The cheque in question should be issued in discharge of a liability and therefore a cheque given as gift will not fall in this category. The cheque should be presented within three months

According to section 131, a banker who in good faith but without negligence receives payment for a customer of a cheque crossed generally or specially to himself, shall not, in the event of the title of the customer to the cheque proving to be defective, incur any liability to the true owner of the cheque for having received such payment *This sections provides protection to a collecting banker of a crossed cheque on behalf of the customer and is available to bank only if it acts in good faith but without negligence.* Given below are a few illustrations of circumstances in which a banker has been deemed to have complied with these conditions:

(i) That the collecting banker has acted in good faith and without negligence. In *Lloyds Bank vs Savoury Co. (1933) A.C. 201*, the court held that if the banker receives payment of a

cheque to which the customer has no title, the onus is on bank to disprove negligence. What amounts to negligence is, however a question of fact in each case. "Negligence" means want of "reasonable care" with reference to the interest of the true owner. The test of "negligence" is whether the transaction of paying in any given cheque coupled with the circumstances antecedent and present was so flagrantly out of the ordinary course that it ought to have aroused suspicion in the mind of the banker and caused him to make enquiry (*Bopulal Prem Chand vs. The Nath Bank Ltd.* 48 Bom. L.R. 393).

(ii) That the collecting banker has received payment of the crossed cheque for a customer. If a banker wants to claim protection under the section then the bank can claim protection of the section if it has received payment from a customer. Customer according to section 31 means a person who has some sort of account, either a deposit or a current account or some similar relation with the bank. [*Lucave Co. vs. Credit Lyonnais* (1897) 1 Q.B. 148].

(iii) That the collecting banker acts only to receive payment of the crossed cheque for customer. The section will be restricted to a case where the banker is acting as an agent for collection but not to a case where the banker is himself the holder. For example, if a customer had overdrawn his account with the bank, and cheque was paid to extinguish that overdrawn account, it was held that the bank was a holder of the cheque for value and not a mere agent for collection. [*McLean vs. Clydesdale Banking Co.* (1883) 9 A.C. 95, 115; *A.L. Underwood Ltd. vs. Barclays Bank* (1914) 1 K.B. 799].

(iv) That the payment has been received only for a crossed cheque, and that crossing had been made before the cheque fell into the hands of the collecting bankers.

If the aforementioned conditions do not co-exist, this protection would be denied to the collecting banker. The protection can be claimed by the collecting banker even when he credited his customer's account with the amount of the cheque before receiving payment thereof. The protection is also available in respect of any draft as defined in Section 85A (Section 131A).

#### Key points

- ◆ A bank under certain conditions may refuse payment of cheque or is bound to dishonour cheque and when the cheque is dishonoured for insufficiency of funds in the account of a customer, it is treated as offence. The guilty may be punished with imprisonment for a term which may extend to two years or with fine of twice the amount of the cheque or with both.

*The payee or holder in due course should give notice demanding payment within 30 days of his receiving information of dishonour which should be for no reason other than insufficiency of funds. The drawer can make payment within 15 days of the receipt of the notice and only if he fails to do so, prosecution can take place. The complaint can be made only by the payee/holder in due course, within one month from the date on which the cause of action arises under Clause (c) of the proviso to Section 138. The period of one month from the cause of action contemplates by Clause (b) of Section 142,*

*within which the complaint for an offence under Section 138 has to be filed, is to be reckoned from the expiry of the period of 15 days from the notice of dishonor within which the maker / drawer of the cheque must make payment under the dishonoured cheque. Earlier there was no scope for the extension of limitation. To obviate this difficulty in cases where there is sufficient cause for not making a complaint within the period of limitation, a proviso to Section 142 (b) has been inserted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002, w.e.f. 6-2-2003. It provides that the cognizance of a complaint may be taken up by the court after the prescribed period, if the complainant satisfies the court that he had sufficient cause for not making a complaint within such period.*

(e) Problems:

(1) A drawer of a cheque after having issued the cheque, informs the drawee not to present the cheque as well as informs the bank to stop the payment. Does it constitute an offence under the Act?

The Supreme Court in *Modi Cements Ltd. vs. Kuchil Kumar Nandi* [1998] 2 CLJ 8 held that once a cheque is issued by the drawer, a presumption under Section 139 must follow and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of the payment, it will not preclude an action under Section 138. The object of Sections 138 to 142 of the Act is to promote the efficacy of the banking operations and to ensure credibility in transacting business through cheques. Section 138 is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or other liability, is returned by the bank unpaid either because of insufficiency of amount to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

(2) Whether the payee or the holder of a cheque can initiate prosecution for an offence under the N.I. Act, for its dishonour for the second time if he had not initiated any prosecution on the first occasion?

Supreme Court in *Sadanandan Bhadrans v. Madhavan Sunil Kumar* [1998] 4 CLJ 228 held that on a careful analysis of Section 138, it is seen that the main part says that it creates an offence when a cheque is returned by the bank unpaid for any of the reasons mentioned therein. The said proviso lays down three conditions precedent to the applicability of the above section and the conditions are:

(1) the cheque should have been presented to the bank within three months of its issue or within the period of its validity.

(2) the payee or the holder in due course of such cheque should have made a demand for payment of the said amount of money by giving a notice in writing to the drawer of the cheque within 30 days [as per the Negotiable Instruments (Amendment and

*Miscellaneous Provisions) Act, 2002] of the receipt of the information by him from the bank regarding the return of the cheque unpaid. [clause (b) of Section 138].*

(3) the drawer of such cheque should have *failed to pay the said amount to the payee or the holder in due course of the cheque within 15 days* of the receipt of the said notice. [Clause(c) of Section 138]

It is only when all the above three conditions are satisfied then a prosecution can be launched for the offence under Section 138.

So far as the first condition is concerned, clause (a) of the proviso to section 138 does not put any embargo upon the payee to successively present a dishonoured cheque during the period of validity. [*Sadanandan Bhadrans vs Madhvan Sunil Kumar AIR 1998 SC 3043*] It is not uncommon for a cheque being presented again and again within its validity period in the expectation that it would be encashed. The question whether dishonour of the cheque on each occasion of its presentation gives rise to a fresh cause of action, the following facts are required to be proved to successfully prosecute the drawer for an offence under Section 138 :-

- (1) that there is a legally enforceable debt .
- (2) that the cheque was drawn from account of bank for discharge in whole or in part of any debt or other liability which pre-supposes a legally enforceable debt.
- (3) that the cheque was presented within the prescribed period;
- (4) cheque so issued had been returned due to insufficiency of fund. [*Krishna Janardhan Bhat vs Dattatraya G. Hegde, 2008(4)SCC 54 : 2008 (1) SCR 605*]
- (5) that the payee made demand for payment of the money by giving a notice in writing to the drawer within the stipulated period;
- (6) that the drawer failed to make the payment within 15 days of the receipt of the notice.

If one has to proceed on the basis of the generic meaning of the terms “cause of action”, certainly each of the above facts would constitute a part of the cause of action, but it is significant to note that clause (b) of Section 142 gives a restrictive meaning in that it refers to only one fact which will give rise to the cause of action and that is failure to make the payment within 15 days from the date of receipt of the notice. [*Sadanandan Bhadrans vs Madhvan Sunil Kumar AIR 1998 SC 3043*]

Besides the language of Sections 138 and 142 which clearly postulates only one cause of action, there are other formidable impediments which negate the concept of successive causes of action. The combined reading of Sections 138 and 142 leave no room for doubt that cause of action within the meaning of Section 142(c) arises and can arise only once.

The final question as how apparently conflicting provisions of the Act, one enabling the payee to repeatedly present the cheque and the other giving him only one opportunity to file a complaint for its dishonour and that too within one month from the date of cause of action arises can be reconciled, the Court held that the two provisions can be harmonised with the

interpretation that on each presentation of the cheque and its dishonour, a fresh right and not cause of action accrues in his favour. *The question of the drawer being prosecuted again and again does not arise as the principle of antreois acquit or antreois convict shall also come in to play.*

Therefore, the holder/payee of a cheque cannot initiate prosecution for an offence under Section 138 for its dishonour for the second time, if he had not initiated such prosecution on the earlier cause of action.

(3) What is the extent of liability of the company and the person(s) in charge of the company in respect of an offence for dishonour of cheques?

From a perusal of Section 141, it is apparent that in case where a company committed an offence under Section 138, then not only the company, but also every person who at the time when the offence was committed, was in charge of, and was responsible to the company shall deemed to be guilty of the offence and liable to be proceeded against under those provisions. *The person will not be liable for punishment, if he proves that the offence was committed without his knowledge or he had exercised all due diligence to prevent the commission of such offence.*

(4) For cognizance of offence for the dishonour of cheque, should the cheque necessarily be presented to the drawee's (payee's) bank or can it be presented before any bank within the stipulated period?

The Act intends to legalise the system under which claims upon mercantile instruments could be equated with ordinary goods passing from hand to hand. To achieve the objective of the Act, the legislature in its wisdom thought it proper to make provision in the Act for conferring such privileges to the mercantile instruments contemplated under it and provide special procedure in case the obligation under the instrument was not discharged. It has, always to be kept in mind that Section 138 of the Act creates strict liability and it has further to be noticed that to make an offence under Section 138 of the Act, it is mandatory that the cheque is presented to the bank within a period of three months, from the date on which it is drawn or within the period of its validity, whichever is earlier. It is the cheque drawn which has to be presented to the bank within the period specified therein. The post-dated cheque becomes a cheque under the Act on the date which is written on the said cheque and the three months period has to be considered, for the purposes of Section 138 of the Act, from the said date.

Note: As per RBI Notifications, dated 4<sup>th</sup> November, 2011 validity period of cheques had been reduced from six months to three months.

Section 138 provides that where any cheque drawn by a person on an account maintained by him with a 'banker' for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by 'the bank' unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with the bank, such person shall be deemed to have



committed on offence punishable with imprisonment as prescribed therein subject to the conditions mentioned in clauses (a), (b) and (c) of the proviso. Section 3 of the Act defines the 'banker' to include any person acting as a banker and any post office savings bank. Section 72 of the Act, provides that a cheque must, in order to charge the drawer, be presented at the bank upon which it is drawn before the relations between the drawer and his banker has been altered to the prejudice of the drawer.

The use of the words 'a bank' and 'the bank' in the section is indicator of the intention of the legislature. The former is indirect article and the latter is pre-fixed by direct article. If the legislature intended to have the same meanings for 'a bank' and 'the bank', there was no cause or occasion for mentioning it distinctly and differently by using two different articles. It is worth noticing that the word 'banker' in Section 3 of the Act is prefixed by the indefinite article 'a' and the word 'bank' where the cheque is intended to be presented under Section 138 is prefixed by the definite article 'the'. The same section permits a person to issue a cheque on an account maintained by him with 'a bank' and makes him liable for criminal prosecution if it is returned by 'the bank' unpaid. The payment of the cheque is contemplated by 'the bank' meaning before nouns, with a specifying of particularising effect opposed to the indefinite or generalising force of 'a' or 'an'. It determines what particular thing is meant that is, what particular thing we are to assume to be meant. 'The' is always mentioned to denote particular thing or a person. 'The' would, therefore, refer implicitly to a specified bank and not any bank. "The bank" referred to in clause (a) to the proviso to Section 138 of the Act would mean the drawee-bank on which the cheque is drawn and not all banks where the cheque is presented for collection including the bank of the payee, in whose favour the cheque is issued.

It, however, does not mean that the cheque is always to be presented to the drawer's bank on which the cheque is issued. The payee of the cheque has the option to present, the cheque in any bank including the collecting bank where he has his account, but to attract the criminal liability of the drawer of the cheque, such collecting bank is obliged to present the cheque in the drawee or payee bank on which the cheque drawn within the period of six months from the date on which it is shown to have been issued. In other words, a cheque issued by (A) in favour of (B) drawn in a bank named (C) where the drawer has an account can be presented by the payee to the bank upon which it is drawn i.e. (C) bank within a period of six months, or present it to any other bank for collection of the cheque amount provided such other bank including the collecting-bank presents the cheque for collection to the (C) bank. The non-presentation of the cheque to the drawee-bank within the period specified in the Section would absolve the person issuing the cheque, of his criminal liability under Section 138 of the Act, who shall otherwise be liable to pay the cheque amount to the payee in a civil action initiated under the law.

A combined reading of Sections 3, 72 and 138 of the Act would leave no doubt that the law mandates the cheque to be presented at the bank on which it is drawn, if the drawer is to be held criminally liable. Such presentation is necessarily to be made within six months at the bank on which the cheque is drawn whether presented personally, or through another bank,

namely, the collecting bank of the payee. [*Shri Ishar Alloy Steels Ltd. (v) Jayaswals Neco. Ltd. (2001) LCLJ 18 (SC)*]

(5) Whether 'giving of notice of dishonour itself constitute 'receipt of notice' for constituting offence under Section 138 of the Negotiable Instruments Act, 1881?

The above matter was considered by the Supreme Court in *Dalmia Cement (Bharat) Ltd v. Galaxy Traders and Agencies Ltd.*, (2001) 5 CLJ 26 SC. The Court observed that, the payee has to make a demand by 'giving' notice in writing and it is a failure on the part of the drawer to pay the amount within 30 days as per Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 of the 'receipt' in writing of the said notice in writing giving is a process of which receipt is the accomplishment. It is therefore clear that 'giving' notice is not the same as 'receipt' of notice. It is for the payee to perform the former process by sending the notice to the drawer at the correct address. The context envisaged in Section 138 of the Act invites a liberal interpretation for the person who has the statutory obligation to give notice because he is presumed to be the loser in the transaction and it is for his interest, that the very provision is made by the legislature. The words in clause (b) of the proviso to Section 138 of the Act shows that the payee has the statutory obligation to make a demand by giving notice. The thrust in the clause is on the need to make a demand. It is only the mode for making such demand, which the legislature has prescribed. A payee can send the notice for doing his part for giving the notice. Once it is dispatched, his part is over and the next depends on what the sender does.

(6) What is the starting point for 30 days notice?

Section 138(b), inter alia, provides that the payee has to make a demand for the payment of money by giving a notice to the drawer of the cheque within 30 days of the receipt of information by him from the bank regarding the return of the cheque as unpaid. Therefore, the 30 days are to be counted from the receipt of information regarding the return of the cheque as unpaid. For *example*, where the cheque was returned on 13th January by the bank with stop endorsement, but the information regarding the return was received by the appellant only on 17th January, since 14th to 16th January happened to be bank holidays and the complainant issued notice on 29<sup>th</sup> January, it cannot be said that the notice issued on 29th January fell outside the prescribed period of 30 days. [*Munoth Investments Ltd. v. Puttukola Properties Ltd. IT 2001 (6) SC 403*]

(7) Whether demand draft is a cheque?

Section 131 of the Negotiable Instruments Act, 1881 is intended to widen the scope of a crossed draft as to contain all incidences of a crossed cheque. This is for the purpose of foreclosing a possibility of holding the view that a draft cannot be crossed. Even if it is possible to construe the draft either as a promissory note or as a Bill of Exchange, the law has given the option to the holder to treat it as he chooses. This can be discerned from the Section 137 which says that where an instrument may be construed either as a promissory note or bill of exchange, the holder may, at his discretion, treat it as either and the instrument shall thence forward be treated accordingly. This means, once the holder has elected to treat the

instrument as a cheque, it cannot but be treated as a cheque thereafter. This is an irretrievable corollary of exercising such an election by the holder himself. A pay order was accordingly held to be a cheque entitling the bank holding the instrument to lodge a complaint under Section 138. [*Punjab & Sind Bank vs Vinkar Sahakari Bank Ltd.*, (2001) 4 CLJ 188 (SC)]

(8) Where an owner of company, who is neither a director nor a person-in-charge, sent a cheque from the companies account to discharge its legal liability. Subsequently the cheque was dishonoured and the complaint was lodged against him. Is he liable for an offence under section 138?

The above facts are based on the *caselaw H.N.D.Mulla Feroze Vs. C.Y.Somayajulu, J* [2004] 55 SCL (AP).

The owner of a company (i.e., petitioner) borrowed a loan of 25 lakhs on behalf of his company from the respondent. Later, at the request of respondent, the petitioner sent a cheque from the companies account. However, the cheque was dishonoured.

The respondent filed a complaint under Section 138 with reference to dishonour of cheque for insufficiency, etc, of funds in the account, against the petitioner and another in connection with the bouncing of a cheque issued on behalf of the company.

This complaint was challenged on the ground that, the petitioner is neither a director nor a person-in-charge of the company and is not connected with the day to day affairs of the company and had neither opened nor is operating the bank account of the company and had not issued the cheque which was dishonoured and further contended that in any event notice of dishonour of the cheque was not served.

The Andhra Pradesh High court held that, although the petitioner has a legal liability to refund amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured, and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner couldn't be said to have committed the offence under Section 138 of the Act.

## 2.10 Rights and obligations of parties to an instrument obtained Illegally (Sections 45A, 58, 59 and 60).

(a) Rights and obligations of the finder of a lost instrument: When a negotiable instrument has been lost, *before it is overdue* the finder or the endorsee from the finder is not entitled to receive the amount of it from maker, acceptor or holder, or from any party prior to such holder. He is bound to return the instrument to the real owner. But if the instrument lost by one and if it passes by delivery, *e.g.*, a bill payable to bearer or endorsed in blank, the third acquiring it *bona fide* and for valuable consideration and before maturity, is entitled both to retain the instrument against the real owner and to compel payment from the prior parties thereon. In other words if the possessor of a lost instrument is a holder of it in due course, he is entitled to receive the amount due thereon from the acceptor or holder or from any party prior to such holder. The possessor or endorsee is also entitled to receive amount when the

person through whom he claims was a holder of the lost instrument in due course.

Under Section 45A, the loser of the instrument has the right to apply to the drawer for a duplicate of the lost bill. If the drawer does not grant the application the loser may compel him to provide him with a duplicate.

(b) **Rights and obligations of a person who had obtained an instrument by unlawful means**(Section 58) : If an instrument is obtained from any maker, acceptor or holder by means of an offence or fraud, the possessor is not, ordinarily, entitled to receive the amount under it from such maker, acceptor or holder, or from any party prior to such holder. *Example:* if X steals a bill from the acceptor, X does not acquire any title to the instrument, and the proceeds of the bill, if collected, could be recovered from X by acceptor. If X transfers it to Y who is a gratuitous transferee, Y too would not acquire any title to the bill. Similarly, if X obtains a bill from the acceptor by fraud, he cannot receive the amount of it, but if he endorses it to Y who receives the bill for value without notice of the fraud, he could collect the amount of the bill from X but from no other party.

(c) **Rights and obligations of a person who has obtained an instrument for unlawful consideration**(Section 58) : When an instrument has been obtained from any maker, acceptor or holder for an unlawful consideration no possessor is, ordinarily, entitled to receive the amount due thereon from such maker, acceptor or holder or from any party prior to such holder. The consideration may be unlawful either because it is immoral and contrary to public policy or because it is specially interdicted or prohibited by the statute. If the possessor endorses it to say, P, even P would not be entitled to claim payment, unless he is holder in due course. P would be regarded as a holder in the course, if it is endorsed to him for valuable consideration without any notice having been received by him as to the consideration being unlawful.

*Effect of forgery* : Where a signature on a negotiable instrument has been forged, it become a nullity and the property in the instrument remains vested in the person who is the holder at the time when the forged signature was put on it. The holder of a forged instrument can neither enforce payment thereon nor give a valid discharge thereof. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue in tort the person who had received. This principle is universal in character, by reason whereof even a holder in due course is not exempt from it. Forgery is not capable of being ratified.

But what would be the effect of a forged endorsement? The answer to this question is wholly dependent upon whether the instrument had been endorsed in full or in blank. In the former case, the person claiming under the forged endorsement even if he is a purchaser for value and in good faith, cannot acquire the rights of a purchaser for value and in good faith cannot acquire the rights of a holder in due course. He acquires no title to the bill or note. (*Mercantile Bank vs. D' Silva*, 30 Bom. L.R. 1225).

**Instrument acquired after dishonour (Section 59):** It has already been pointed out that the holder in due course is not affected by the defect in the title of his transferor; but it is not so in

the case of a holder who acquires the instrument after dishonour, or after maturity.

The holder of instrument, who has acquired it after dishonour, has as against the other parties, only the rights thereon of his transferor. For *example*, receive the amount of it from the other parties because the endorsee too could not do so.

**Instrument acquired after maturity (Section 59):** The holder of an overdue instrument too is affected by the defect in title of his transferor. For *example*, Q accepts a bill drawn by P and deposits with P certain goods as collateral security for the payment of bill. The bill, not having been paid at maturity, P sells the goods and retains the proceeds, but in breach of faith endorses the bill to R. R, having only the right of P, cannot realise the amount of the bill from Q. But if R were bona fide endorsee before maturity, he could realise the amount from Q.

**Liabilities on an accommodation note or bill (Proviso to Section 59):** In the case of accommodation bills or notes, a defect in the title of the transferor does not affect the title of the holder acquiring after maturity. An accommodation may be explained as follows: X draws a bill payable to himself on Y, who accepts the bill without consideration just to accommodate X, that is, to enable X to raise money by negotiating the bill in the market. Though Y accepts the bill, X is primarily liable on the bill, and he cannot demand the amount from Y, for in an accommodation bill, the acceptor is only surety for the party accommodated. However, if the accommodation bill, in the above illustration, is transferred by X to Z for good consideration after maturity and Z becomes the holder in good faith, Z will be able to realise the amount of the bill from Y, the acceptor though Z's transferor X could not, at the date of transfer, recover anything from Y.

**Duration of negotiation (Section 60):** An instrument may be negotiated until payment thereof by the maker, drawee or acceptor at or after maturity, but not after such payment. But the maker, drawee or acceptor cannot negotiate the instrument after maturity, even if it remains unpaid. An instrument may be satisfied even without payment, and such satisfaction is equivalent to payment.

#### Key points

- ◆ Finder of a lost instrument does not get a good title to it. The true owner can recover the amount from the finder. This rule is same in case of stolen instrument. (ii) Instrument obtained by unlawful means- the possessor is not, ordinarily, entitled to receive the amount under it from such maker, acceptor or holder, or from any party prior to such holder (iii) Instrument for unlawful consideration- Such an instrument is void and create no obligation of the parties to it.(iv) forged instruments- persons who forges an instrument ,gets no title on the instruments, even holder in due course cannot claim. (v) Instrument acquired after dishonour- The holder of instrument, who has acquired it after dishonour, has as against the other parties, only the rights thereon of his transferor. (vi) Instrument acquired after maturity- The holder of an overdue instrument too is affected by the defect in title of his transferor (vii) Liabilities on an accommodation note or bill. A defect in the title of the transferor does not affect the title of the holder acquiring after maturity. (viii) Duration of negotiation- An instrument may be negotiated until payment thereof by the maker, drawee or acceptor at or after maturity, but not after such payment.

*Discharge from liability on Notes, bills and cheques:*

(a) **Distinction between discharge from liability of a party and discharge of the instrument:** An instrument is said to be discharged only when the party who is ultimately liable thereon is discharged from liability. *The rights in respect of such an instrument can still be enforced against those parties who are still liable thereon.* Therefore, discharge of a party to an instrument does not discharge the instrument itself. Consequently, the holder in due course may proceed against the other parties liable for the instrument. For *example*, the endorser of a bill may be discharged from his liability, but even then acceptor may be proceeded against. On the other hand, when a bill has been discharged by payment, all rights there under are extinguished, even a holder in due course cannot claim any amount under the bill.

(b) **Different modes of discharge from liability:** Parties to negotiable instrument are discharged from liabilities when the right of action on the instrument is extinguished. The right of action on a negotiable instrument is extinguished by the following methods:

- (i) *By payment in due course* : The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon to all parties thereto if the instrument is payable to bearer, or has been endorsed in blank and such maker, acceptor or endorser makes payment in due course of the amount due thereon i.e., when the payment has been made to the holder of the instrument at or after maturity in good faith and without notice of any defect in the title to the instrument (Section 82).
- (ii) *By cancellations of acceptor's or endorser's name:* The maker, acceptor and endorser respectively of a negotiable instrument is discharged from liability thereon to a holder thereof who has cancelled such acceptor's or endorser's name with the intent to discharge him and to all parties claiming under such holder. In other words, if the holder (payee) of a bill cancels the signature of acceptor (drawee) with an intention to discharge him, both maker (drawer) and the acceptor of such negotiable instrument are discharged from the liability to the holder and to all parties claiming under such a holder [Clause (a) Section 82.]
- (iii) *By release:* The maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon to a holder thereof who has renounced his right in respect of the instrument. The waiver of the right may be expressed or implied [Clause (b) of Section 82].
- (iv) *By default of the holder:* If the holder of a bill of exchange allows the drawee more than forty-eight hours, exclusive of public holiday, to decide whether he will accept the bill, all prior parties not consenting to such an allowance are discharged from liability to such holder. It is because if the drawee fails to signify his acceptance within forty-eight hours, the holder must treat the instrument as dishonoured and he must at once give notice to the drawer and to all prior parties, and must not allow time unless they give their consent that more time should be allowed (Section 83).

- (v) *Dissenting parties discharged by qualified or a limited acceptance*: If the holder of a bill who is entitled to an absolute and unqualified acceptance elects to take a qualified acceptance, he does so at his own peril and discharges all parties prior to himself unless he obtains their consent to such an acceptance. Thus, the previous parties are discharged when acceptance of a bill is qualified *in the following cases* (1) *when acceptance is conditional* (2) when acceptance is for a part of the sum, (3) when acceptance substitutes a different place or time of payment, (4) when acceptance is not signed by the drawees not being partners.

They are discharged, if such acceptance is acquiesced in by the holder without obtaining their previous consent. They are discharged as against the holder and those claiming under him. But, if they subsequently approve of such acceptance by the holder, they will not be discharged (Section 86).

- (vi) *By material alteration of the instrument without assent of all parties liable* : Any material alteration of a negotiable instrument renders the same void as against anyone who is party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties and any such alteration, if made by an endorsee, discharges his endorser from all liability to him in respect of the consideration thereof (Section 87). The alteration must be so material that it alters the character of the instrument to a great extent. Alteration of the date, alteration of the amount payable, or alteration of the time and the alteration on the place of payment of the instrument are regarded as material alterations of the instrument. *In Hongkong and Shanghai Bank vs. Lee Shi* (1928) A.C. 181, it has been held that an accidental alteration will not, however, render the instrument void. It is necessary to show that the alteration has been made improperly and intentionally.
- (vii) *By payment, alteration not being apparent*: If, however, a person pays an altered note, bill or cheque, provided the alteration is not apparent and payment is made in due course by person or a banker who is liable to pay the amount he is protected (Section 89). For example, if A draws a cheque for ₹ 8 in favour of B who fraudulently converts eight into eighty, and the alteration is not apparent, the banker, paying ₹ 80 to B will not be liable to the drawer for the amount paid in excess.
- (viii) *By acceptor becoming holder of a bill at or after maturity in his own right*: If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished (Section 90).
- (ix) *By default in presenting the cheque within a reasonable time*: In the case of a cheque, if it is not presented for payment within a reasonable time of its issue and the drawer or person on whose account, it is drawn had the right at the time when presentment ought to have been made as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged to the extent of such damage, that is to say, to the extent to which such drawer or person is creditor of the banker to a larger amount that he would have been if such cheque had been paid [Section 84(1)].

For *example*, if X draws 10 cheques of ₹ 100 each, but when the cheque ought to be presented, has only ₹ 600 at the bank and subsequently the bank fails before the cheques are presented, X will be released from liability to the extent of ₹ 600 but will remain liable for the balance. If he had the full amount of ₹ 1,000 at the bank, he will be discharged in full.

**Note:** In the above case liability of the drawer will be transferred to the banker. For determining what is reasonable time for presentation, the following matters would be considered: (i) nature of instrument (ii) usage of the trade and bankers and (iii) facts of the case.

- (x) *By operation of law:* It should be noted that a negotiable instrument is also discharged by operation of law which may occur in any one of the following circumstances. (a) By lapse of time i.e., when the claim under the instrument becomes barred by the Limitation Act on the expiry of the period prescribed for the recovery of the amount due on the instrument; (b) By merger, i.e., when the debt, under the instrument is merged in the judgement debt obtained against the acceptor, maker or endorser; (c) Under the law of insolvency, i.e., when the acceptor, maker, or endorser, who has been adjudicated an insolvent, is discharged by an order of the Court made in the insolvency proceedings.
- (xi) *By payment by the drawee of a cheque payable to order or to bearer:* Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee who always is a banker is discharged by payment in due course. A cheque is said to have been paid in due course, when it has been paid in good faith, after taking proper care to ascertain the genuineness of the endorsement. Payment in due course discharges the bank from liability even if the payment is made to a wrong person even if the endorsement of the payee is forged. The banker is discharged from the payment in good faith and without negligence. But if the drawer's signature is forged, the banker can, under no circumstances, claim discharge on payment, for the banker is presumed to know the signature of his customer (i.e. the drawer).

The bank is discharged by payment in due course to the bearer notwithstanding any endorsement thereon, whether in full or in part and whether or not such endorsement purports to restrict or exclude further negotiation. The endorsee under an endorsement in full cannot recover the amount from the banker who has paid it to the bearer (Section 85).

The rule of the discharge applicable to a cheque payable to order also applies, to a draft drawn by one of the bank upon another payable to order or demand (Section 85A).

**Key points**

- ◆ Mode of discharge – The instrument is discharged when rights and obligations or claims of all the parties are extinguished.
- ◆ Material Alteration means the alteration in the material part of the instrument resulting in the alteration in the basic parts of the nature and legal effects of the instruments and the liabilities of the parties.



## 2.11 Notice of Dishonour

(a) **Dishonour by non-acceptance (Section 91):** A bill may be dishonoured either by non-acceptance or by non-payment. A dishonour by non-acceptance may take place in any one of the following circumstances: (i) when the drawee either does not accept the bill within forty-eight hours (exclusive of public holidays) of presentment or refuse to accept it; (ii) when one of several drawees, not being partners, makes default in acceptance; (iii) when the drawee makes a qualified acceptance; (iv) when presentment for acceptance is excused and the bill remains unaccepted; and (v) when the drawee is incompetent to contract.

**Note:** Presentment for acceptance not necessary where the drawee after diligent search cannot be found, or where the drawee is incompetent to contract or where the drawee is a fictitious person.

When a bill has been dishonoured by non-acceptance, it gives the holder an immediate right to have recourse against the drawer or the endorser. Since a dishonour by non-acceptance constitutes a material ground entitling the holder to take action against the drawer, he need not wait till the maturity of the bill for it to be dishonoured on presentment for payment (*Ram Ravji Jambekar vs. Prahladdas 20 Bom.133*).

(b) **Dishonour by non-payment (Section 92):** An instrument is dishonoured by non-payment when the party primarily liable e.g., the acceptor of a bill, the maker of a note or the drawee of a cheque, makes default in payment. An instrument is also dishonoured for non-payment when presentment for payment is excused and the instrument, when overdue, remains unpaid, under Section 76 of the Act.

**Distinction between dishonour by non-acceptance and by non-payment:** If a bill is dishonoured by non-acceptance, there is no right of action against the drawee as he is not a party to the bill: the holder of the bill can proceed only against the drawer or endorser, if any. On dishonour by non-payment the drawee can be sued.

(c) **Notice of dishonour (Sections 93 and 94):**

(i) *By whom notice to be given:* When an instrument is dishonoured either by non-acceptance or by non-payment, the holder thereof or some party thereto who remains liable thereon must give notice of dishonour. *Ram Ravji Jambekar vs. Prahladdas 20 Bom.133. Notice of dishonour to the drawer is absolutely necessary and unless and until it is given, the holder has no cause of action against him.*

(ii) *To whom notice is to be given:* Notice must be given to such parties whom the holder proposes to charge with liability severally or jointly, e.g., the drawer and the endorsers. Notice may be given either to the party himself or to his agent, or to his legal representative on his death, or to the official assignee on his insolvency. It is not necessary to give notice to the maker of a note or the drawee or acceptor of a bill or cheque.

(iii) *Effect of non-service of notice:* If a notice of dishonour is not sent to any prior party who is entitled to such notice within a reasonable time, he is discharged from liability. It is a

condition precedent to the continuation of the liability of the drawer under Section 30 and of the endorser under Section 35 of the Act that they should be notified of the dishonour.

(iv) *Requirements of valid notice*: The holder must inform the party to whom the notice has been given that the instrument has been dishonoured, and that he will be held liable thereon. It must give an exact description of the instrument dishonoured, for wrong description which misleads the addressee, vitiates the notice.

(v) *Mode of service of notice* : The notice, if written, may be given by post at the place of business or at the residence of party for whom it is intended, and even if it is miscarried, the notice is not rendered invalid by such miscarriage. When the holder of the instrument and the party to whom notice is given, carry on business or live in different place, the notice of dishonour must be despatched by the next post, it is sufficient if the notice is so despatched that it reaches its destination on the day next after the day of dishonour.

(d) *Transmission of notice of dishonour by party receiving it (Section 95)*: Any party receiving notice of dishonour should communicate the same within a reasonable time to any prior party whom he intends to hold liable in respect of the instrument; but if the prior party receives otherwise, no such communication is necessary.

*Illustration:*

A draws a bill which he endorses to B ;

B endorses it to C;

C endorses it to D;

D endorses it to E;

E endorses it to F.

*Suppose if F presents this bill for payment on maturity to the acceptor and he dishonours it. F, the holder, gives notice of dishonour to the drawer, as well as B, C, D and E. If F the holder, gives a notice of dishonor to his prior party i.e. only to E, he (E) may communicate the notice to his own prior parties D, C, B & A ,the drawer whom they want to make liable. When a number of persons are required to give notice to a certain person it is not necessary that all of them must give the notice. If one of them has given notice of dishonor, the other persons can take advantage.*

(e) *When notice of dishonour is unnecessary (Section 98)*: In a suit against the drawer or endorser on an instrument being dishonoured, notice of dishonour is a material part of the cause of action.

However, in the following cases the notice of dishonour is not necessary: (i) When the necessity of the notice has been dispensed with by an express waiver by the party entitled to it. For *example*, when the drawer of a bill informs the holder that the bill will be dishonoured on presentment, the notice of dishonour is said to have been dispensed with [*Brett vs. Levett* (1811) 13 East 213]. (ii) When the drawer has countermanded payment, he, having put an

impediment in the way of the holder obtaining payment is not entitled to the notice of dishonour. (iii) When the party charged could not suffer damage for want of a notice. In such a case neither presentment nor notice of dishonour is necessary, provided it is shown that at the time of drawing the instrument there were no funds belonging to the drawer in the hands of the drawee [*Subrao vs. Sitaram* 2 Bom. L.R. 891]. (iv) When the party entitled to notice after due search, cannot be found. (v) Where there has been accidental omission to give the notice, provided the omission has been caused by an unavoidable circumstances, e.g., death or serious illness of the holder or his agent, or other inevitable accident, or overwhelming catastrophe not attributable to the default, misconduct or negligence of the party tendering notice. (vi) When one of the drawers is acceptor. From this, it is also possible to deduce a further rule that notice of dishonour is not necessary for charging the drawer where the drawer and the acceptor are the same person. However, the mere fact that the drawer and drawee of a bill are partners does not give rise to the presumption that they are partners in respect of the drawing of the bill, or that the bill was drawn by one of them on behalf of both. [*Jambu Ramaswamy vs. Sundraraja Chetti* 26 Mad. 239]. Such a case does not fall under purview of the rule mentioned above, so as to dispense with notice. (vii) In the case of promissory note which is not negotiable, (viii) When the party entitled to notice, knowing the facts, promises unconditionally to pay the amount due on the instrument.

#### Key points

- ◆ An instrument is dishonoured by non-acceptance and non-payment of the instrument when duly presented.
- ◆ Notice of dishonor is served by the holder formally against the parties to the effect that instrument has been dishonored by non-acceptance or non-payment.

## 2.12 Noting and Protesting

(a) **Noting:** It is a convenient mode of authenticating the fact that a bill or note has been dishonoured. When a note or a bill has been dishonoured by non-acceptance or non-payment, the holder causes such dishonour to be noted by a Notary Public. Noting is a minute recorded by a notary public on the dishonoured instrument. When an instrument, say a bill of exchange, is to be noted for dishonour, is taken to Notary Public who presents it once again for acceptance or payment, as the case may be; and if the drawee or acceptor still refuses to accept or pay the bill, it is noted, i.e., a minute is prepared containing the date of dishonour, reason for such dishonour, etc. which is attached to the instrument; and the facts are noted on the instrument.

(b) **Protest:-** When an instrument is dishonoured, the holder may cause the fact not only to be noted, but also to be certified by a Notary Public that the bill has been dishonoured. Such a certificate is referred to as a protest.

If the creditor or an acceptor of a bill is shaken by insolvency or otherwise before the date of maturity of the bill, the holder may cause such a fact also to be noted and certified. Such a certificate is called a protest for better security. The contents of a protest are given in Section 101 of the Act.

Neither noting nor protesting is compulsory in the case of inland bills. But under Section 104 every foreign bill of exchange must be protested for dishonour when such a protest is required by the law of the country where the bill was drawn. The advantage of both noting and protesting is that this constitutes *prima facie* good evidence in the Court of the fact that instrument has been dishonoured. It is necessary to note that under Section 119, the Court is bound to recognise a protest. But it may or may not recognise noting. To make good this lacuna, Section 104A was introduced. It clarifies the position that any bill or document which has been noted can be protested any time thereafter for taking legal action against the parties. Thus, where a document has been noted within the time required by law, legal proceeding cannot be vitiated on account of protest not having been made.

(c) **Notary Public:** A Notary public is appointed by the Central or State Government. His functions are to attest deeds, contracts and other instruments that are to be used abroad and to give a certificate of due execution of such documents. He enjoys the confidence of the business world, and any certificate given by him is presumed to be true by a court of law. The profession of notaries is regulated by the Notaries Act, 1952.

(d) **Notice of Protest:** When a promissory note or a bill of exchange is required by law to be protested, notice of such protest in lieu of notice of dishonour must be given in the same manner as notice of dishonour (Section 102). *Notice of protest may be given either by the holder or by the notary who makes the protest.*

#### Key Points

- ◆ Noting is the process of recording the fact and reasons of dishonor of a negotiable instrument by the notary public.
- ◆ Protest is a certificate issued by a notary public attesting the fact of dishonor of a negotiable instrument recorded upon the instrument.
- ◆ Important difference between the two is that noting consists of recording the fact and reasons of dishonor of N.I upon the instrument whereas protest is the certificate as to the fact that instrument has been dishonoured.

### 2.13 Acceptance and Payment for Honour and reference in Case of Need

**Acceptance for honour:-** If a bill has been dishonoured by non-acceptance and has been duly noted or protested for such dishonour, any person, before it is overdue, who is not a party already liable under the bill may, with the consent of the holder of the bill, by writing on the bill, accept the bill for the honour of any of the parties liable on it. The object of such an acceptance for honour is to protect the credit of the party liable on the bill, and to prevent legal proceedings being taken against him.

**Conditions for valid acceptance for honour:** These are: (i) that the bill has been noted or protested for non-acceptance or better security; (ii) that such an acceptance has been made with the consent of the holder, (iii) that the acceptor for honour is not a party already liable on the bill, (iv) that the acceptance is for the honour of any party already liable on the bill; and (v) that the acceptance is by writing on the bill.

**Rights and Liabilities of such acceptor:** Section 111 of the Act states that an acceptor for honour binds himself to all parties subsequent to the party for whose honour he accepts to pay the amount of the bill if the drawee does not. But an acceptor for honour is not liable to the holder of the bill unless it is presented or (in case the address given by such acceptor on the bill is a place other than the place where the bill is made payable) forwarded for presentment not later than the day next after the day of its maturity. Moreover, an acceptor for honour cannot be charged unless the bill has been presented at its maturity to the drawee for payment and has been dishonoured by him and noted or protested for such dishonour (Section 112).

Section 111 further provides that the party for whose honour the acceptor accepts to pay and all prior parties become liable in their respective capacities to compensate the acceptor for honour for all loss or damage sustained by him in consequence of such acceptance.

**Payment for honour:** It is a payment which is made by any person for the honour of any party liable on the bill after it has been protested for non-payment. The condition essential for such payment are, (i) that the bill must have been noted or protested for non-payment (ii) that the person paying or his agent declares before Notary Public the party for whose honour he pays; (iii) that such declaration has been recorded by such Notary Public; (iv) that the payment must be made for the honour of any party liable to pay the bill and (v) that the payment may be made by any person whether he is already liable on the bill or not.

The effects of such a payment are:

All parties subsequent to the party for whose honour it is paid are discharged.

- (1) The payer for honour acquires the rights *in respect of the bill at the time of such payment of a holder* whom he pays and becomes entitled to all the remedies of the holder on the instrument,

- (2) The payer can recover all sums paid by him together with the interest and expenses properly incurred in making such payment (Section 114).

According to Section 115 where a “drawee in case of need” is named in a bill or in any endorsement thereon, it is obligatory for the holder to present the instrument to him *i.e.*, the drawee in case of need, and it will not be considered to have been dishonoured, unless it has been dishonoured by such drawee. The failure to present the bill to the drawee in case of need absolves the drawer from liability (*Bahadur Chand v. Gulab Rai AIR Lah 557*). Again according to the Bombay High Court if a bill of exchange has been duly accepted but dishonoured when presented to drawee in the first instance for payment, it cannot be validly presented for payment to the drawee in case of need if it was not first presented to him for acceptance [*Dore vs. Kanchiwalla & Co. 40 Bom. LR 473*].

#### Key Points

- ◆ Acceptance for honour means the acceptance given by some stranger when the original drawee refuses to accept or to give better security when demanded by a notary. The stranger may accept the bill of the honour of any party already liable thereto. Such a stranger is called an acceptor for honour or acceptor *supra protest*.
- ◆ Payment for honour is the payment of a duly noted or protested bill dishonoured by non-payment, made by a person *i.e.*, stranger, for the honour of any party liable on the bill.

### 2.14 Presentment of Instruments

(a) Presentment of bills for acceptance (Section 61): A bill of exchange is not necessarily required to be presented for acceptance, before its being presented for payment. For *example*, a bill payable on demand, payable certain number of days after date, payable on a certain day, etc., need not be presented for acceptance. Although it is a matter of common practice to obtain acceptance of the bill by the drawee at the earliest opportunity after it is drawn, such an acceptance is not absolutely essential to the bill being a negotiable instrument. For *example*, a person to whom a bill has been negotiated before acceptance may sue thereon as a holder in due course. [*National Park Bank of New York vs. Berggren & Co. (1914) 110 L.T. 907*].

It should, however, be noted that in two cases presentment for acceptance would be necessary, namely :

- (i) where a bill is payable after sight - presentment for acceptance is with a view to fixing the maturity of the instruments.
- (ii) where a bill expressly stipulates that it shall be presented for acceptance.

But when a bill is not payable after sight, presentment is unnecessary to render any prior party liable. It is, however, prudent for the holder of such bill to present it for acceptance, for if it is accepted, he obtains the security of the acceptor's signature and if it is not accepted he is relieved of the necessary presentment for payment.

*How, when and by whom bill is to be presented :* A bill payable after sight is to be presented to the drawee by a person entitled to demand acceptance, and it is generally the holder of the bill who is entitled to demand acceptance. The bill must be presented by the holder within a reasonable time after it is drawn, and in business hours on a business day either at the residence or at the place of business of the drawee. But if the bill itself indicates a place of presentment, it must be presented at the place. If the drawee cannot, after reasonable search, be found, the bill is to be regarded as dishonoured for non-acceptance. When authorised by agreement of usage, a presentment through the post office by a registered letter is sufficient.

*Drawee's time for deliberation:* Under Section 63, the drawee is entitled to a respite of forty eight hours (exclusive of public holidays) to consider whether he should accept a bill presented to him for acceptance.

*When presentment is excused:* Presentment for acceptance is excused if the drawee is a fictitious person (Section 91) or even after a reasonable search, the drawee can not be found (Section 61). Again even if presentment is made irregularly, such an irregularity is excused if the bill has been dishonoured by non-acceptance on some other ground.

(b) *Presentment of promissory note for sight (Section 64):* When and why a note is to be presented for sight? Like a bill of exchange payable after sight, a promissory note payable at a certain period after sight must be presented to the maker for sight. The presentment is to be made by a person entitled to demand payment who is usually the holder. Again, the note must be presented within a reasonable time after it is made and in business hours on a business day. In default of such presentment, the maker is not liable to pay anything to the holder. The necessity for presentment, in the case of such a note, viz., a note payable at a certain period after sight, is obvious; without such presentment the maturity of the note cannot be fixed.

(c) *Presentment of instrument for payment:* Presentment of a bill of exchange means its exhibition to drawee or acceptor by holder with a request for payment in accordance with its apparent tenor (Section 64). Presentment may be made through post by means of a registered letter if such a mode of presentment is authorised by agreement or usage. If the bill is paid, the holder would have to hand it over to the payer. In default of presentment, the drawer and the endorser would be discharged from their liability to the holder.

(i) *By whom and to whom presentment is to be made:* Presentment is to be made either by the holder or by somebody on behalf of the holder. Promissory notes are to be presented to the maker; bills of exchange are to be presented to the acceptor; and cheque are to be presented to the drawee.

(ii) *Time of presentment for payment:* (a) Presentment should be made during the usual business hours (Section 65). (b) If the bill is made payable at a specified period after date or sight, it must be presented for payment at its maturity (Section 66). (c) If the bill is payable on demand, it must be presented for payment within a reasonable time after its receipt by the holder (Section 74).

(iii) *Place of presentment for payment:* (a) If the bill is drawn or accepted payable at a specified place and not elsewhere, it must be presented for payment at that place, in

order to charge any party to the bill (Section 68). (b) If, however the bill is accepted payable at a special place (the word “and not elsewhere” being omitted) then to charge the drawer (but not the acceptor), presentment should be made at the place specified (Section 69). (c) If no place of payment is specified then the bill should be presented for payment at the place of business (if any) or the residence of the drawee or acceptor or (if he has no fixed place of business or residence) to him in person wherever he can be found (Sections 70 and 71).

- (iv) *Presentment of promissory note payable by instalment (Section 67)*: A promissory note payable by instalments must be presented for payment on the third day after the date fixed for payment of each instalment.
- (v) *Presentment of cheque to drawer (Section 72)*: It is the duty of the holder of cheque to present it at the bank upon which it is drawn. If payment is refused by the bank, the holder may sue the drawer. If the holder sues the drawer without first presenting the cheque at the bank, the suit will be dismissed.

If the holder does not present the cheque at the bank in time, the position of the bank may become unsound and it may not be possible for the banker to honour the cheque; in this case, the drawer is not liable if the bank refuses payment on presentment. The rule is that the cheque must be presented before the relation between the drawer and his banker has been altered to the prejudice of the drawer.

- (vi) *Distinction between drawer of bills and drawer of cheques*: If a bill is not presented in time, the drawer is absolutely discharged; but the drawer of a cheque, in case of delay in presentment, is discharged only if he has suffered some loss or injury and that too, to the extent of such loss only. Therefore, if the bank remains solvent, the drawer will remain bound after presentment and refusal, although months (short of the period of limitation) have elapsed since the drawing.
- (vii) *Presentment of cheque to charge any other person (Section 73)*: It may be recalled that in order to charge the drawer, the cheque must be presented before the relation between the drawer and his banker has been altered to the prejudice of the drawer, but in order to charge any person other than the drawer the cheque must be presented within a reasonable time. For *example*, A draws a cheque in favour of B, who endorses it to C. C must present it at the bank within a reasonable time, otherwise B will be discharged from liability.
- (viii) *Presentment of instrument to agents, etc. (Section 75)*: Presentment for acceptance or payment may be made not only to the drawer, maker or acceptor but also to his duly authorised agent or where he is dead to his legal representative, or where he has been declared an insolvent, to his assignee.



(d) When presentment is unnecessary (Section 76):

- (i) No presentment for payment is necessary in any of the following cases; (1) if the maker, or acceptor intentionally prevents the presentment of the instrument; (2) if the instrument being payable at his place of business, he (*i.e.*, maker, drawer or acceptor) closes such place of a business, during the usual business hours; (3) if the instrument being payable at some other specified place, neither he nor any person authorised to pay it attends at such place during the usual business hours; (4) if the instrument not being payable at any specified place, he (*i.e.*, maker, etc.) cannot after due search be found.
- (ii) No presentment for payment is necessary as against any party sought to be charged with payment, if he himself has engaged to pay notwithstanding non-presentment.
- (iii) No presentment for payment is necessary as against any party if, after maturity and with the knowledge that instrument has not been presented:
- (iv) (1) He makes a part-payment on account of the amount due on the instrument; or (2) he promises to pay the amount due thereon in whole or in part; or (3) he otherwise waives his right to take advantage of any default in presentment for payment.

When we say that no presentment for payment is necessary, we mean thereby the instrument is taken as dishonoured at the due date for presentment even though it has not been presented. The result is that the holder may sue the party liable without presentment and the plea that the instrument was not presented for payment is no defence to the claim of the holder.

Key points

- ◆ Acceptance of a bill means putting signature on the bill by the drawee with a view to signifying his assent for the payment of the amount of the bill at maturity.
- ◆ Acceptance is required only in case of bill of exchange but every bill is not required to be presented for acceptance.
- ◆ Acceptance and presentment of acceptance is compulsory only in case of a bill payable after sight.
- ◆ Presentment of negotiable instrument is essential in order to get payment at maturity.

## 2.15 Payment and Interest

- (a) To whom payment should be made (Section 78): Payment of the amount due on a promissory note, bill of exchange or cheque must, in order to discharge the maker or acceptor, be made to the holder of the instrument. If payment is made to any person other than the holder, the holder can claim payment over again from the maker or acceptor.

- (b) **Payment of interest when rate is specified (Section 79):** Where interest at a specified rate is expressly made payable on a promissory note or a bill of exchange, interest shall be calculated at the rate specified, on the amount of the principal money due thereon; (i) from the date of the instrument until tender or realization of such amount, or (ii) from the date of the instrument until such date after the institution of a suit to recover the principal amount as the Court directs.
- (c) **Payment of interest when no rate is specified (Section 80):** When no rate of interest is specified in the instrument, interest on the amount due shall be calculated at the rate of 18% per annum from the date at which the instrument ought to have been paid until tender or realization of the amount due, or until such date as the Court directs.

**Key Points**

- ◆ Payment of the amount due on instruments must be made to the holder with an interest at the specified rate expressly made payable on a promissory note or a bill of exchange. When no rate of interest is specified in the instrument, interest on the amount due shall be calculated at the rate of 18% per annum from the date at which the instrument ought to have been paid until realization of such amount.

**2.16 International Law regarding Negotiable Instrument**

In the absence of a contract to the contrary (*i.e.*, unless the parties otherwise agree), the liability of the maker or drawer of a foreign promissory note, bill of exchange or cheque is governed in all essential matters by the law of the place where he made the instrument. The respective liability of the acceptor and endorser, in such cases, will be governed by the law of the place where the instrument is made payable (Section 134). For *example*, if a bill of exchange was drawn by A in California where the rate of interest was 25% it was accepted by B, payable in Washington, where the rate of interest was 6% and the bill was endorsed in India and was dishonoured. On an action on the bill being brought against B in India, B would be liable to pay interest @ 6% only; but if A was charged as drawer, A would be liable to pay interest @ 25%.

When the foreign instrument made is payable in a place different from that at which it is made or endorsed, the law of the place where the instrument is made payable would determine what constitutes dishonour and what notice of dishonour is sufficient (Section 135). *It is to be noted that in this case the proper time for payment and for the notice of dishonor is fixed by the law of the country where the payment is to have been made.*

If the instrument is made, drawn, accepted or endorsed abroad, but it is in accordance with the law of India, any subsequent acceptance or endorsement thereon India will not be regarded as invalid, because the agreement as evidenced by such an instrument is invalid according to the law of such foreign country (Section 136)

*Courts in India do not take judicial notice of foreign law. Any person relying on such law relating to negotiable instruments must prove it by evidence and in the absence of*

*such evidence, the courts shall presume the law of any foreign country to be the same as that of our country. (Section 137)*

#### Special rules of evidence

(a) **Presumption as to negotiable instrument (Section 118):** For deciding cases in respect of rights of parties on the basis of a bill of exchange, the Court is entitled to make certain presumptions until the contrary is proved. These are briefly stated as follow:

- (i) That the negotiable instrument was made or drawn for consideration and every party who made itself bound in respect thereof did so for consideration;
- (ii) That the negotiable instrument was drawn on the date shown on the face of it;
- (iii) That the bill of exchange was accepted before its maturity, *i.e.*, before it became overdue;
- (iv) That the negotiable instrument was transferred before its maturity;
- (v) That the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.
- (vi) That an instrument which has been lost was properly stamped;
- (vii) That the holder of a negotiable instrument is the holder in due course, except when the instrument has been obtained from its lawful owner or its lawful custodian. Likewise, if it has been obtained from a maker or acceptor by means of an offence or fraud, it is for the holder to prove that he is the holder in due course.

*The presumptions mentioned above do not arise unless there is a proper protest according to Section 99, Section 100 and Section 101 of the Act.*

(b) **Certain rules of estoppel applicable to instruments:** When one person causes another person to believe a thing to be true and to act upon such belief he is not allowed in a suit between him and such person, to deny the truth of that thing. That is, he is not allowed to give evidence in support of his denial. This rule is called the rule of estoppel, by which evidence is excluded. There are certain rules of estoppel applicable to negotiable instruments. These are contained in Sections 120 to 122 of the Act.

The objective of these provisions are: (i) that the original parties to the instrument shall not deny the validity of the instrument; (ii) that the maker of a promissory note or an acceptor of a bill shall not deny the right of the payee to receive the payment therefore; and (iii) that an endorser of a negotiable instrument shall not deny the signature or capacity to contract of any prior party to the instrument.

#### Key points

- ◆ The liability of the maker or drawer of a foreign promissory note, bill of exchange or cheque is governed in all essential matters by the law of the place where he made instrument. The respective liability of the acceptor and indorser, in such cases, will be governed by the law of the place where the instrument is made payable.

- ◆ In respect to decide the rights of parties on the basis of negotiable instrument, the Court is entitled to make certain presumptions ----- of consideration ,as to date, as to time of acceptance, as to time of transfer ,as to order of indorsements, as to stamps and that holder is a holder in due course.
- ◆ There are certain rules of estoppel applicable to negotiable instruments in order not to effect on the validity of the instrument, right of the payee to receive the payment and so on.

*Hundis: Bills of exchange drawn up in the vernacular are generally known as Hundis. The Negotiable Instruments Act ordinarily is not applicable to Hundis but, the title of the Act conveys the idea that the Act is a comprehensive enactment relating to all kinds of negotiable instruments whether negotiable by law, or by usage or custom. So, the parties to the Hundis may agree to be governed by the Negotiable Instruments Act, 1881.*

### 2.17 Different Types of Hundis

The most common types of hundis are the following:

- (i) *Shah Jog Hundi*:- In this case, apart from a drawer and a drawee, there is another party to the instrument known as Shah (a financial of repute). It is only payable to Shah. The function of the Shah is that he presents the hundi, when it eventually comes to him for payment to the drawee on behalf of the holder. In so far this Shah acts like a banker to whom a cheque has been endorsed specially.
- (ii) *Jokhmi Hundi*: The term “Jokhmi” itself means “against risk”. It is documentary bill which is drawn by a consignor or the consignee in respect of goods shipped by the consignor. The name of the vessel by which the goods have been shipped is also mentioned in the hundi. The consignee is not required to pay the hundi unless the goods reach their destination. If, however, the ship is lost, the consignor or the person with whom he has negotiated the hundi, has to suffer the loss.
- (iii) *Nam Jog Hundi*: It is a hundi payable to the party named therein or to his order. The party, however, has a right to endorse it in favour of any other person as can be done in case of any other bill of exchange.
- (iv) *Jawabee Hundi*: It is an instrument for remitting money and takes the form of ordinary letter advising the party that he may collect money from a banker. The remitter hands over the hundi to his banker who in turn endorses it to a correspondent residing near the payees place of residence. The correspondent on receiving the letter forwards it to the payee *who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel to the drawer of the order.*
- (v) *Dhani Jog Hundi*: This is a Hundi payable to Dhani or owner *i.e.* a person who purchase it.
- (vi) *Firman Jog Hundi*: This is a Hundi payable to order.

### Certain terms explained

(i) *Zikri Chit*: According to the usage shroffs in the case of Marwari hundis, a hundi may be accepted for honour. It is a letter of protection addressed to a merchant in the town where a hundi is payable and issued to the holder of the hundi by some prior party liable thereon. The letter, it is intended, would be used by the holder if the hundi is dishonoured by non-acceptance. The letter contains a request to the merchant that he may accept the hundi in case of dishonour.

(ii) *Peth and Perpeth* : Peth is the duplicate copy of hundi, issued on the loss of the original hundi, and perpeth is the triplicate copy of the hundi given on the loss of the peth.

(iii) *Khoka* : After a hundi has been paid and cancelled it is called a Khoka.

**Classification of hundis according to time of payment** : Hundis payable at darshan or sight are known as darshani hundis and those payable at a certain period after date are known as miadi hundis. A darshani hundi is transferable by endorsement. In drawing a miadi hundi, the interest for the period of hundi is charged. A miadi hundi is known in Bengali as the muddati hundi.

## 2.18 Rules of Compensation

Under Section 117 of the Act, the compensation payable in case of dishonour of a promissory note, bill of exchange, or cheque, by any party liable to the holder or any endorsee, shall be determined by the following rules :

- (a) The holder is entitled to the amount due upon the instrument, together with the expenses incurred in presenting, noting and protesting it;  
The holder is entitled to receive: (1) the amount of the instrument; (2) interest on the principal sum as calculated in accordance with the rules mentioned in Sections 79 and 80; and (3) expenses properly incurred in presenting, noting and protesting the instrument.
- (b) When the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;
- (c) *The endorser, who being liable, has paid the amount due under the instrument, is entitled to the amount so paid with interest at 18% per annum from the date of payment until tender or realisation together with all expenses caused by the dishonour and non-payment. But an endorser who has paid a bill or note is entitled to the amount so paid only if at the time of payment he was liable on the instrument. The endorser is only entitled to charge interest at the rate of 18% per annum on the amount paid by him, even though interest at a higher rate is mentioned in the instrument.*

*It is to be noted that the endorser can charge his prior party with all the expenses caused by dishonor. This may include expenses of postage, stamp for receipt of the payment etc.*

- (d) When the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between the two places.

*Clause (d) lays down a rule with reference to endorsers similar to that laid down by clause (b) which deals with the case of a holder, but with this difference under clause (b) the rate of exchange in the case of a holder who pays the amount is to be determined at the current rate of exchange between the place where the person charged resides and the place at which the instrument was payable. Under this Clause if the person charged and the indorser are at different places the rate of exchange between the two places determines the quantum of liability. On principle there should be no difference between the rights of a holder and of an endorser in this respect the endorser too is entitled to receive the equivalent of the sum which he has paid according to the current rate of exchange. Clauses (b) and (c) relate to 're-exchange'. Re-exchange is the measure of damages occasioned by the dishonour of a bill in a country different from that in which it was drawn or endorsed. When a person sought to be charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two countries. Re-exchange, in its usual application, means the loss resulting from the dishonour of a bill in a country different from that in which it was drawn. [Williams vs. Ayres (1877) 3 A.C. 133, 146]. As the holder of the instrument sustains loss to the extent of the amount mentioned in the instrument on the day of dishonour, the rate of exchange should be taken for calculation as of the rate prevailing on the date of dishonour. [In re British American Continental Bank Ltd. (1972), 2 Ch. 575, 589; S.S. Celia vs. volturna (1921) A.C. vs. 544 Muller Maclean & Co. vs. Atanlla & Co., 51 Cal. 320].*

- (e) The party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill.

The bill mentioned in this clause is called a re-draft. The party entitled to compensation is enabled to draw a bill payable at sight or on demand on party liable to compensate him for the amount due to him together with all expenses properly incurred by him. The re-draft must be accompanied by the dishonoured instrument and the protest thereof if there be any. In case the draft is dishonoured the party on whom it is drawn is liable to make compensation in accordance with the rules laid down in this section in the case of the original bill. *Now the amount payable are of two kinds (a) the amount due upon the instrument; and (b) the amounts payable are the expenses incurred on presenting, noting, protesting and the like.*

#### Key Points

- ◆ The compensation payable by any party liable to the holder or any endorser in case of dishonour of an instruments shall be determined by the rules given under Section 117 of the Act.